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ARIZONA CORPORATION COMMISSION  
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Docket #(s): E-04230A-14-0011

E-01933A-14-0011

Arizona Corporation Commission

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Exhibit #: JA11-JA16, S1-S3, NS1, NS2, SAHBA1,

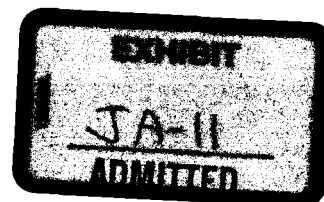
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Part 2 of 2

**IN THE MATTER OF  
UNS ENERGY CORPORATION AND FORTIS INC.**

**DOCKET NO. E-04230A-14-0011**

**DOCKET NO. E-01933A-14-0011**



**DIRECT TESTIMONY  
OF  
JOHN J. REED  
ON BEHALF OF  
UNS ENERGY CORPORATION AND AFFILIATES  
AND  
FORTIS INC. AND AFFILIATES**

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**I. INTRODUCTION**

**Q. Please state your name, affiliation, and business address.**

A. My name is John J. Reed. I am Chairman and Chief Executive Officer of Concentric Energy Advisors, Inc. ("Concentric") and CE Capital, Inc. located at 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

**Q. Please describe your educational background and professional experience in the energy and utility industries.**

A. I have more than 35 years of experience in the energy industry, and have worked as an executive in, and consultant and economist to, the energy industry for the past 30 years. Over the past 23 years, I have directed the energy consulting services of Concentric, Navigant Consulting and Reed Consulting Group. I have served as Vice Chairman and Co-CEO of the nation's largest publicly-traded consulting firm and as Chief Economist for the nation's largest gas utility. I have provided regulatory policy and regulatory economics support to more than 100 energy and utility clients and have provided expert testimony on regulatory, economic and financial matters on more than 150 occasions before the FERC, Canadian regulatory agencies, state utility regulatory agencies, various state and federal courts, and before arbitration panels in the United States and Canada. A copy of my Curriculum Vitae is included as **Exhibit JJR-1**. A list of prior proceedings in which I have provided testimony is included as **Exhibit JJR-2**.

**Q. Please describe Concentric's and CE Capital's activities in energy and utility engagements.**

A. Concentric provides financial and economic advisory services to many and various energy and utility clients across North America. Our regulatory economic and market analysis services include utility ratemaking and regulatory advisory services, energy market assessments; market entry and exit analysis, corporate and business unit strategy development, demand forecasting, resource planning, and energy contract negotiations. Our financial advisory activities include both buy and sell side merger, acquisition and divestiture assignments, due diligence and valuation assignments, project and corporate



1 finance services, and transaction support services. In addition, we provide litigation  
2 support services on a wide range of financial and economic issues on behalf of clients  
3 throughout North America. CE Capital is a fully registered broker-dealer securities firm  
4 specializing in merger and acquisition activities. As CEO of CE Capital, I hold several  
5 securities licenses that cover all forms of securities and investment banking activities.

## II. PURPOSE AND OVERVIEW OF TESTIMONY

6 **Q. What is the purpose of your testimony in this proceeding?**

7 A. I have been asked by UNS Energy Corporation ("UNS Energy" or the "Company") and  
8 Fortis Inc. ("Fortis") to provide testimony regarding the context for the ongoing  
9 consolidation in the electric utility industry, the key drivers for consolidation of the  
10 industry, and how the proposed acquisition of UNS Energy by Fortis might be beneficial  
11 to UNS Energy and the Company's customers.

12 **Q. How is the remainder of your testimony organized?**

13 A. Section III of my testimony summarizes my conclusions regarding the consolidation that  
14 has occurred in the electric utility industry. Section IV discusses the primary drivers of  
15 consolidation in the electric utility industry in recent years. As discussed in more detail  
16 in Section IV, those drivers have included: (1) an increased need for capital investment  
17 that is not growth-oriented and does not produce additional revenue; (2) declining  
18 demand resulting from energy efficiency objectives, on-site generation development, and  
19 challenging economic conditions; (3) projected conditions in capital markets; (4) the  
20 benefits of achieving improved credit metrics and credit ratings; and (5) the need to  
21 maintain earnings growth prospects. Section V provides the credit rating agencies'  
22 perspective on consolidations in the electric utility industry. In Section VI, I compare  
23 UNS Energy and the investor-owned utility holding companies in terms of scale, scope  
24 and financial strength. Finally, in Section VII, I summarize the benefits that can be  
25 expected for UNS Energy and its customers as a result of the Company's acquisition by  
26 Fortis.

### III. SUMMARY OF CONCLUSIONS

1 **Q. Please summarize your conclusions regarding the consolidation of the electric utility**  
2 **industry.**

3 A. As discussed in the remainder of my testimony, there has been steady consolidation of  
4 the electric utility industry since 1995, with the number of electric investor owned  
5 utilities ("IOUs") declining by more than 50 percent from approximately 100 companies  
6 to 48 companies, as reported by Value Line.<sup>1</sup> As discussed in more detail in Section IV  
7 of my testimony, industry trends such as declining customer usage and increased capital  
8 spending for non-revenue producing investments, as well as weak economic conditions  
9 over the past several years, have stretched utility balance sheets and placed pressure on  
10 credit metrics.

11 Current and projected capital needs of electric utilities are driven by expenditures  
12 that are not growth oriented or revenue producing, without rate increases. Capital  
13 investments include environmental upgrades to comply with current and expected  
14 government rules and regulations, necessary transmission and distribution expansion for  
15 renewable energy integration and system reinforcement, and investments in new and  
16 emerging technologies, all of which are necessary investments to maintain and improve  
17 the distribution system but do not produce incremental revenue. The magnitude of these  
18 investments often requires utilities to seek access to capital markets at the lowest cost  
19 possible.

20 At the same time that utilities are facing increased capital requirements, projected  
21 market conditions are such that the era of extraordinarily low debt costs, which has  
22 benefitted all utilities, has likely come to an end. Over the past year, interest rates have  
23 risen significantly, and the expectation is for that trend to continue as the Federal Reserve  
24 tapers the extraordinary Quantitative Easing program that has been in place since the  
25 financial crisis of 2008-2009. As interest rates rise and the cost of both debt and equity

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<sup>1</sup> Value Line is a widely known and relied on financial reporting service that provides historical information and market projections for the electric utility industry.

1 increase, utilities with stronger balance sheets and higher credit ratings will have access  
2 to capital at more favorable terms, all of which benefits customers and shareholders.

3 **Q. How will the acquisition be beneficial to UNS Energy and its customers?**

4 A. The acquisition of UNS Energy by Fortis will result in UNS Energy being part of a much  
5 larger and financially stronger company with access to capital on more favorable terms  
6 than the Company can currently obtain. UNS Energy and its customers should benefit  
7 from the increased size and financial strength resulting from the Fortis acquisition. Fortis  
8 has committed to an equity injection of \$200 million into UNS Energy to strengthen its  
9 balance sheet and to help fund the acquisition of the Gila River Power Plant, a transaction  
10 that will reduce Tucson Electric's reliance on coal-fired power.

11 Furthermore, like many smaller utilities, UNS Energy has significant capital  
12 investment projected to meet ongoing maintenance requirements, to provide safe and  
13 reliable service and to meet a variety of specific challenges related to energy delivery,  
14 generation, security, and environmental regulation. The Company is projecting that the  
15 investment required to meet these challenges is in excess of \$1 billion over the 2014-  
16 2015 forecast horizon. That level of investment will require significant access to capital  
17 from outside sources. The acquisition of UNS Energy by Fortis is expected to improve  
18 the financial strength of UNS Energy and will provide the company with access to capital  
19 on more favorable terms than would be supported if UNS Energy remained a small,  
20 stand-alone utility.

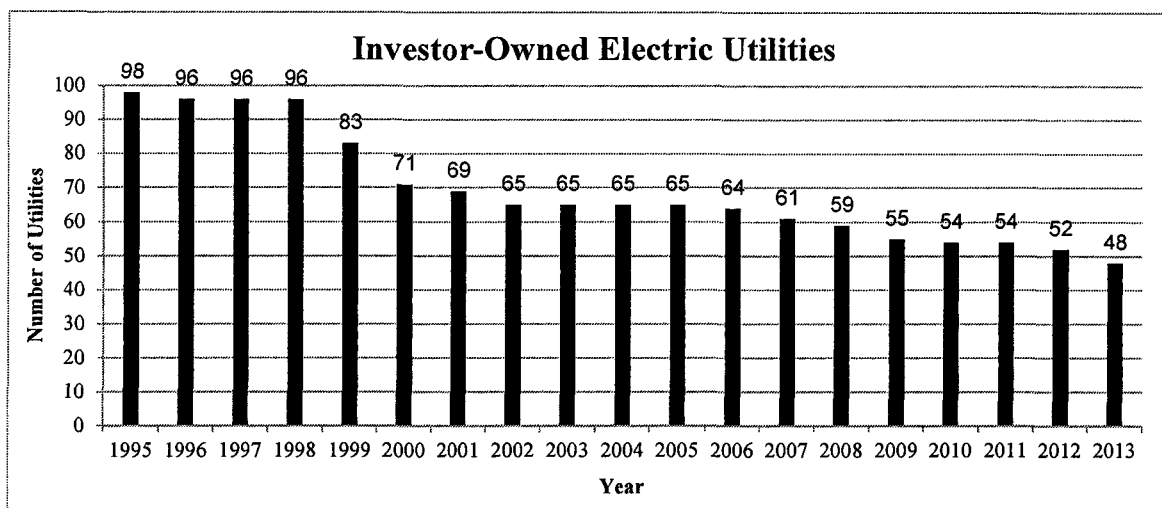
21 Fortis has also stated, among other things, that UNS Energy's operations will  
22 remain under local control with current management and staffing levels and no planned  
23 changes to existing operations or rates. Therefore, UNS Energy's customers will continue  
24 to benefit from local operations and employment, as well as from Fortis' commitment to  
25 supporting the local economy and the community.

#### IV. ELECTRIC INDUSTRY CONSOLIDATION

26 **Q. How have mergers and acquisitions reshaped the electric utility industry?**

A. As shown in Chart 1, below, since 1995, the number of electric IOUs has declined more than 50 percent, from approximately 100 companies in January 1995 to 48 companies as of November 2013.<sup>2</sup>

**Chart 1: U.S. Investor-Owned Electric Utilities 1995-2013**



Industry consolidation has resulted in significant concentration among the largest IOUs. Examples include: Duke Energy Corp/Cinergy; Duke Energy Corp/Progress Energy Inc.; Exelon Corporation/Constellation Energy, Inc.; FirstEnergy Corp/Allegheny Energy, Inc.; and Northeast Utilities/NSTAR. Ongoing industry consolidation has resulted in the formation of much larger electric utility holding companies over the past decade. This trend toward industry concentration highlights one important reason that smaller electric utilities, such as UNS Energy, would consider merging or being acquired. In particular, by becoming part of a larger company, smaller electric utilities can continue to compete effectively with larger entities for debt and equity capital to finance their capital investment requirements.

**Q. Is there an expectation that large-scale mergers will continue to dominate the electric utility industry?**

No. While large-scale mergers have resulted in the formation of some extremely large utility companies, more recent expectations with respect to ongoing industry

<sup>2</sup> Sources: EEI 2012 Financial Review, at 49 and Value Line Electric Utility Segment data as of November 30, 2013.

1 consolidation have focused on the mid-sized companies. Industry analysts project that  
2 trend to continue and have identified several mid-sized companies that may be well-  
3 positioned for acquisition. In October 2013, prior to the announcement of this transaction,  
4 several medium-sized utilities were identified as consolidation candidates, including:  
5 Vectren Utility Holdings; Cleco Power LLC; Empire District Electric Company; and  
6 UNS Energy Corp.<sup>3</sup>

7 **Q. Please explain why growth prospects are more challenging for electric utilities in the**  
8 **current environment.**

9 A. Electric utilities have faced declining demand resulting from a combination of weak  
10 economic conditions and demand reductions due to energy efficiency and on-site  
11 generation measures. The declining demand in some jurisdictions and the slow growth in  
12 other jurisdictions, combined with general increases in operating costs have placed  
13 pressure on utilities' cash flows, balance sheets, and credit metrics.

14 **Q. How do electric utility capital expenditure plans affect their financial strength?**

15 A. Electric utility capital investment plans have significant infrastructure enhancement and  
16 environmental compliance components, which require substantial capital investments that  
17 often require additional access to debt or equity markets. However, since infrastructure  
18 enhancements and environmental compliance investments do not result in a larger  
19 customer base or increased customer demand, these investments do not generate any  
20 incremental revenue to offset the additional capital financing requirements. For smaller  
21 electric utility companies, the magnitude of these non-revenue producing capital  
22 financing requirements can place significant strain on the company's credit metrics.

23 **Q. The Fortis acquisition of UNS Energy is not an expansion of a neighboring utility**  
24 **system. Have there been other mergers or acquisitions that do not involve**  
25 **neighboring utility companies?**

26 A. Yes. Drivers for industry consolidation have advanced beyond the search for synergies  
27 and operational economies of scale that can be achieved through the consolidation of

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<sup>3</sup> "Utility Companies to continue mergers and acquisitions," *Electric Light & Power/POWERGRID International*, October 30, 2013.

1 neighboring utilities. Recent mergers and acquisitions reflect the importance of  
2 geographic diversification and financial strength in the electric utility industry. Examples  
3 of these types of mergers include the Fortis acquisition of CH Energy Group, Inc., the  
4 Berkshire Hathaway subsidiary, MidAmerican Energy Holdings Co. ("MidAmerican"),  
5 acquisition of Nevada Power, the acquisition of Duquesne Light Holdings, Inc. by a  
6 consortium of investors<sup>4</sup> and the Puget Holdings LLC<sup>5</sup> acquisition of Puget Energy.

7 **Q. What were the primary drivers of those transactions?**

8 A. In each case, the dominant purchaser in those transactions was not a local neighboring  
9 utility that was seeking to capture synergies (i.e., cost savings and economies of scale)  
10 through the combination of local operations. Rather, the acquiring company in each of  
11 those transactions was seeking to diversify its customer base and to achieve enhanced  
12 access to capital for the acquired electric utility. The following summarizes the capital  
13 investments provided in each of these transactions:

- 14 • Puget Holdings committed to support Puget Energy and its wholly-owned  
15 subsidiary, Puget Sound Energy's \$5 billion capital program for infrastructure  
16 projects to maintain and improve the utility's reliability, in addition to other  
17 savings.
- 18 • The acquisition of Duquesne Power and Light by the Macquarie Consortium  
19 provided an equity infusion of \$141 million that was to be used to fund  
20 Duquesne's ongoing infrastructure investment program and acquisition of  
21 ownership interest in generation assets.
- 22 • MidAmerican indicated that the merger would benefit NV Energy and its  
23 customers through increased financial stability, lower debt costs and increased  
24 access to capital that would be needed to make new generation and transmission  
25 investments.<sup>6</sup>

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<sup>4</sup> The consortium was led by Macquarie Infrastructure Partners and Diversified Utility and Energy Trusts.

<sup>5</sup> Puget Holdings LLC was comprised of a group of long-term infrastructure investors including Macquarie Infrastructure Partners.

<sup>6</sup> SNL Energy, Update: "MidAmerican, NV Energy close merger after gaining FERC's approval," December 19, 2013.

- Fortis' acquisition of CH Energy Group, Inc. included capital expenditure commitments of \$215 million at the subsidiary, Central Hudson Gas & Electric ("CHG&E") in the first 24 months. Over the period from 2013 through 2017, CHG&E's capital expenditure plan was projected to be \$600 million.

**Q. What does it mean to diversify the customer base?**

A. Companies examine their existing customer base and growth prospects and seek to mitigate the risks associated with that customer base either through geographic diversity or the acquisition of a company that has a different load profile. Avista Corp's recently announced plan to acquire Alaska Energy Resources Co. and TECO Energy's ("TECO") acquisition of New Mexico Gas Company ("NMG") are examples of transactions where diversification was a driver.

- Avista Corp/Alaska Energy Resources - Avista stated that its strategy in this acquisition was to expand and diversify its energy assets.
- TECO Energy/New Mexico Gas Co. - TECO Energy had seen declining revenue resulting from warm weather and low natural gas prices, which depressed coal prices. TECO stated publicly that this transaction would increase its customer base by 50 percent, provide future growth in an "attractive Sunbelt location", increase the percentage of earnings from regulated operations, and reduce earnings volatility.

**Q. What is expected with respect to merger and acquisition activity in the electric utility sector going forward?**

A. Industry analysts are expecting merger and acquisition activity to continue in the electric utility industry, with a focus on smaller to mid-sized electric utility companies. The primary drivers of consolidation for this segment of the industry will be the need for financial stability and access to capital to finance the increasing capital expenditure programs that are necessary to expand and replace existing infrastructure for reliability purposes and to comply with environmental mandates and conservation goals. As discussed previously in my Direct Testimony, UNS Energy was identified, along with other smaller utilities, as possible merger candidates. Therefore, it is reasonable to expect

1 that UNS Energy could have been presented other merger or acquisition offers that may  
2 not have been as locally focused and community and customer oriented.

V. RATING AGENCY PERSPECTIVES ON ELECTRIC UTILITY MERGER  
ACTIVITY

3 **Q. Have the credit rating agencies offered any perspective on consolidation in the**  
4 **electric utility industry?**

5 A. Yes. Both Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's")  
6 expect that utility mergers will continue. In a recent presentation, Moody's concluded  
7 that the rationale for utility industry consolidation is "compelling", citing several  
8 motivating factors: (1) building scale and scope; (2) spreading fixed costs over larger  
9 asset platforms; (3) capturing operating efficiencies; (4) diversification of business and  
10 operating risks and geographic and weather exposure; (5) combining complementary  
11 operations; (6) generating financing efficiencies/access to capital markets; (7) growth in  
12 earnings; (8) addressing rising operating costs; (9) meeting demand for infrastructure-  
13 related capital expenditures; and (10) better management of larger projects.<sup>7</sup> Furthermore,  
14 Moody's notes that since the financial crisis, credit quality has been a key factor in utility  
15 mergers.

16 S&P also projects that utility mergers will continue, as utilities seek to create  
17 larger, more diverse and more efficient organizations that have better credit profiles and  
18 superior access to capital.<sup>8</sup>

19 **Q. What are the primary factors that affect the credit ratings of the parties in merger**  
20 **transactions?**

21 A. The primary factors discussed by the rating agencies in their review of mergers include:  
22 (1) the credit ratings of the parties; (2) expected changes in capital structure as a result of  
23 the merger; and (3) the regulatory conditions necessary for merger approval. In situations  
24 where the debt burden of the acquired company remains unchanged and the acquiring

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<sup>7</sup> Moody's Investors Service, "A Rating Agency Perspective on the Utility Industry," June 25, 2012, p. 24.  
<sup>8</sup> Standard & Poor's RatingsDirect, "Opportunity for U.S. Regulated Electric Utility Mergers in the U.S. Still  
Exists," March 12, 2012.



1 company has a stronger credit rating, the acquisition or merger has generally resulted in  
2 an increase in the credit rating or credit outlook for the acquired company. Significant  
3 increases in debt at either the parent or subsidiary level as a result of the merger have  
4 resulted in negative credit watch implications. Finally, rating agencies pay particular  
5 attention to the financial implications of the conditions imposed by the regulatory  
6 agencies approving the transactions.

7 **Q. Please provide examples of mergers that resulted in improved credit ratings for the**  
8 **acquired company.**

9 A. There are several recent mergers that have resulted in improved credit ratings for the  
10 acquired company. In most cases, the acquiring company had a stronger credit rating  
11 than the acquired company, resulting in a credit rating upgrade or a positive outlook for  
12 the acquired company.

- 13 • FirstEnergy/Allegheny - Prior to the merger, Moody's rated FirstEnergy Baa3 and  
14 Allegheny as Ba1 rating. After the merger, Moody's upgraded Allegheny to Baa3.
- 15 • Gaz Metro/Green Mountain Power - S&P placed Green Mountain Power on  
16 "credit watch positive" following the merger, reflecting the possibility that Green  
17 Mountain Power's credit profile may improve as a result of its affiliation with a  
18 stronger entity.<sup>9</sup>
- 19 • Berkshire Hathaway/NV Energy - S&P placed NV Energy on credit watch for a  
20 possible upgrade following the announcement that MidAmerican Energy  
21 Holdings, a subsidiary of Berkshire Hathaway, would acquire the company. S&P  
22 stated that "The CreditWatch placement indicates our belief that there is at least a  
23 50% likelihood that the ratings of NV Energy and its subsidiaries will be raised  
24 during the next six months".

25  
26 FitchRatings also placed NV Energy on CreditWatch positive, noting that the  
27 completion of the acquisition would likely result in a one-notch upgrade of NV Energy  
28 and its utility subsidiaries. FitchRatings anticipates increased financial flexibility and

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<sup>9</sup> SNL Energy: "S&P Places Green Mountain Power on CreditWatch Positive," June 22, 2006.

1 lower funding costs will accrue to NVE due to association with a larger, financially  
2 strong parent company.<sup>10</sup>

3 **Q. How have regulatory conditions and requirements on mergers and acquisitions**  
4 **affected credit ratings?**

5 A. Some regulators have required merger applicants to provide certain regulatory conditions  
6 that have negative financial implications for the acquired utility. Depending on the  
7 magnitude of the requirements, these conditions can have negative implications on cash  
8 flow metrics that are considered in establishing a company's credit rating.

9 **Q. Please summarize the effect of mergers and acquisitions on credit ratings for electric**  
10 **utility companies.**

11 A. Rating agencies look closely at the structure of mergers and acquisitions involving  
12 electric utility companies to determine the overall effect on credit ratings. To the extent  
13 that the acquired company's balance sheet takes on significant incremental debt as a  
14 result of the transaction, or the conditions required by regulators place pressure on cash  
15 flow metrics, rating agencies have tended to downgrade the acquired company.  
16 Conversely, acquisitions that place the acquired company in a more favorable financial  
17 position to be able to meet its ongoing capital needs have resulted in a credit upgrade or  
18 the expectation of future increases in credit ratings for the acquired company.

19 **Q. How have rating agencies responded to the Fortis acquisition of UNS Energy?**

20 A. Based on the initial review of the terms of the Fortis acquisition of UNS Energy, rating  
21 agencies' review of the transaction have been generally positive. For example, S&P  
22 revised its outlook on TEP from stable to positive, citing the higher rating of Fortis and  
23 the expectation that the acquisition of TEP would be "moderately strategic". Fitch  
24 Ratings ("Fitch") placed TEP's rating on Rating Watch Positive, reflecting its expectation  
25 that the utility's access to capital would improve due to Fortis' financial strength and the  
26 expectation that Fortis will support TEP's growth objectives. Moody's commented that  
27 it views Fortis' ownership of UNS Energy as neutral to positive for UNS Energy, due to

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<sup>10</sup> *Ibid.*

1 the access to scale and scope, which may help fund capital investments and greater access  
2 to the capital markets.<sup>11</sup>

## VI. COMPARISON OF ELECTRIC IOUS AND UNS ENERGY

3 **Q. Credit rating agencies have identified scale, scope and financial strength as key**  
4 **factors in the consolidation of the industry. Have you conducted any analysis of**  
5 **these factors for the current electric IOUs as compared to UNS Energy?**

6 A. Yes, using the companies that Value Line classifies as Electric Utilities as representing  
7 the universe of electric IOUs, I compared UNS Energy to those companies on three  
8 factors: (1) market capitalization; (2) number of customers; and (3) credit rating. These  
9 factors are useful measures in determining the overall size and financial strength of UNS  
10 Energy relative to the electric utility industry.

11 **Q. What is market capitalization?**

12 A. Market capitalization is one of the main ways that investors measure the size of a  
13 company. In addition, market capitalization provides an indication as to the overall level  
14 of risk of an investment. Market capitalization is calculated as the product of the number  
15 of shares outstanding and the current stock price. Market capitalization is typically used  
16 by investors to segment companies into three categories: (1) large-cap – more than \$10  
17 billion; (2) mid-cap - \$2 billion to \$10 billion; and (3) small-cap – less than \$2 billion. In  
18 general, larger companies (in terms of market capitalization) are considered to have lower  
19 risk and require lower returns, while smaller companies have higher risk and require  
20 higher returns.

21 **Q. Please summarize your analysis of market capitalization.**

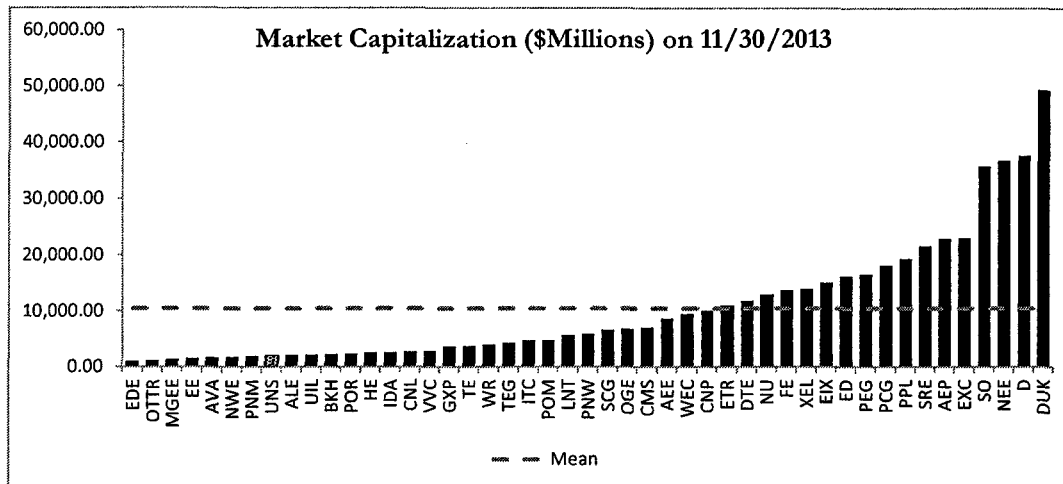
22 A. As shown in Chart 2 below, as of November 30, 2013, prior to Fortis' announcement of  
23 its intention to acquire UNS Energy, the range of market capitalization for the Value Line

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<sup>11</sup> See In the Matter of the Reorganization of UNS Energy Corporation, Joint Notice of Intent to Reorganize, January, 10, 2014, p. 6. S&P Ratings Direct Research Update, "Fortis Inc. Outlook Revised to Negative on Proposed Acquisition of UNS Energy Corp.," December 13, 2013. FitchRatings "Fitch Places Tucson Electric Power Co.'s Ratings on Rating Watch Positive on merger Announcement," December 13, 2013. Moody's "Issuer Comment: Fortis Inc.'s proposed acquisition of UNS Energy Corporation has no immediate ratings impact," December 12, 2013.

electric utilities segment was from approximately \$976 million to \$49.3 billion. The mean capitalization of the group was \$10.5 billion. At that time, UNS Energy's market capitalization was \$1.9 billion, which is at the low end of the range for the Value Line IOUs.

**Chart 2: Market Capitalization of the Value Line Electric Utilities**



**Q. Why did you compare UNS Energy to other electric utilities in terms of the number of customers?**

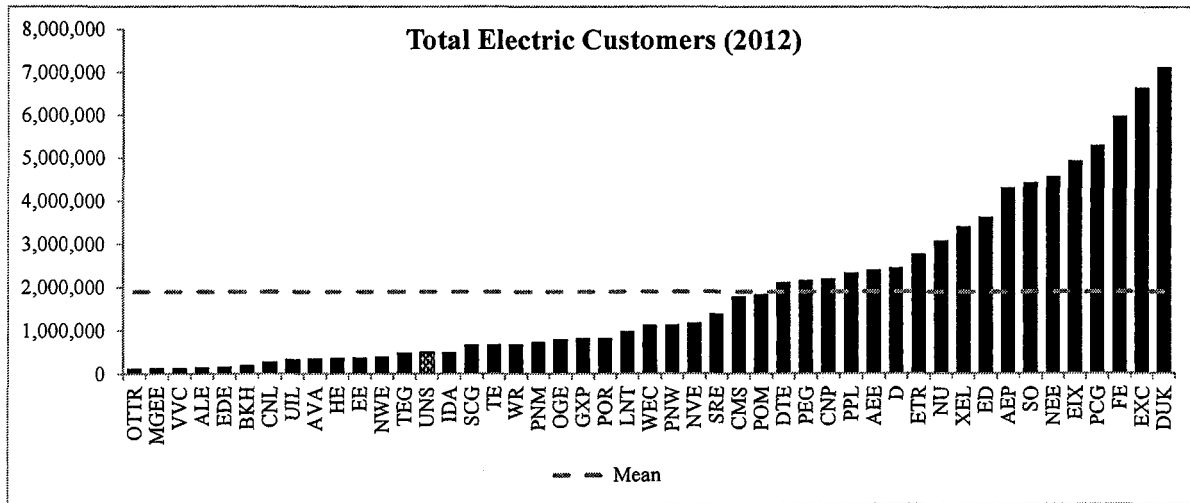
**A.** The purpose of the customer metric is to establish the relative size of UNS Energy to the other electric IOUs. While there are normally differences in the composition of the customer classes (i.e., residential, commercial, industrial) among companies, I used a total customer metric to establish the overall size of UNS Energy relative to the electric utility segment.

**Q. Please summarize the results of that analysis.**

**A.** As shown in Chart 3 below, the electric IOUs range in size from 129,000 customers to 7.0 million customers. The mean of the electric IOU group is 1.9 million customers. As of November 30, 2013, UNS Energy had slightly less than 500,000 electric utility customers in its regulated utility subsidiaries, Tucson Electric Power and UNS Electric, meaning that UNS Energy is a relatively small electric utility.

1

**Chart 3: Value Line Electric Utilities - Number of customers**



2

3

4 **Q. How does the credit rating of UNS Energy compare to the electric IOU peer group?**

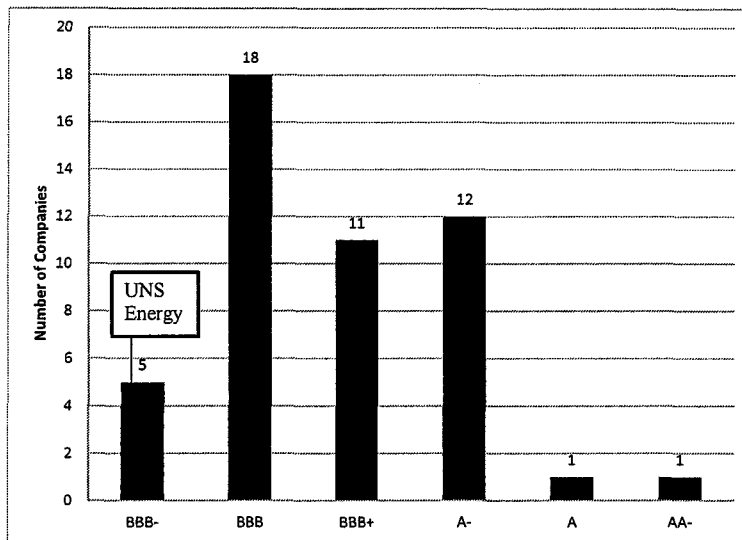
5 A. Chart 4 summarizes the ratings of the electric IOUs using the S&P credit rating scale.<sup>12</sup>

6 As shown in Chart 4 below, the most common credit rating for electric IOUs is BBB,  
 7 followed by A-. With a long-term issuer rating of Baa3 from Moody's, which is generally  
 8 considered equivalent to a BBB- rating from S&P, UNS Energy is at the low end of the  
 9 range for electric utility credit ratings. As is typical for many utility holding companies,  
 10 the debt of UNS Energy's operating subsidiaries (Tucson Electric Power ("TEP"), UNS  
 11 Electric and UNS Gas) is rated one notch higher by Moody's at Baa2. TEP also has a  
 12 long-term issuer rating of BBB from S&P and BBB- from Fitch Ratings.

13

<sup>12</sup> Since the majority of the electric IOUs are rated by S&P, the credit rating analysis was performed using the S&P credit rating scale.

Chart 4: Investor-Owned Electric Utility Credit Ratings<sup>13</sup>

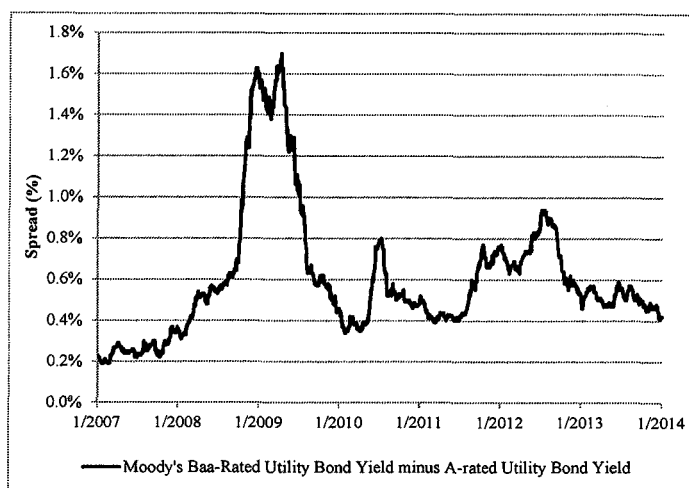


**Q. How does the utility's credit rating affect its cost of capital?**

**A.** Investors consider the credit rating of a company as one factor in establishing their return requirements. The difference in the cost of debt at different credit ratings is readily observable. Moody's reports the yield on a utility bond index with A and Baa credit ratings (which correspond to the S&P scale of A and BBB). As shown in Chart 5 below, the credit spread, which is the difference between the yield on the A and Baa-rated utility bonds of the same maturity, shows the difference in debt cost between bonds issued at an A rating and a Baa rating (BBB on the S&P rating scale).

<sup>13</sup> Analysis includes the Value Line electric utility segment. Credit ratings are as of November 30, 2013 and are based on the S&P rating's scale. If the IOU was not rated by S&P and was rated by Moody's, the Moody's rating was converted to the equivalent S&P rating for this analysis.

**Chart 5: Credit Spread Moody's Baa- and A- rated Utility Bond Indexes**



As shown in Chart 5, the credit spread has been volatile since the beginning of the financial crisis, demonstrating the importance of maintaining a strong financial profile, especially during periods of stress in financial markets. Recently, the spread between the Baa and A rated utility bond index yields has narrowed to approximately 45 basis points.<sup>14</sup> However, as shown in Chart 5, during periods of financial distress, the credit spreads can increase substantially. The proposed Fortis acquisition of UNS Energy provides the opportunity for UNS Energy, and its regulated utility subsidiaries, to improve their financial profile and credit ratings, which will be especially beneficial to the Company and its customers when financial markets experience another significant disruption that causes borrowing costs to increase, especially for lower rated utilities.

**Q. What are the implications of the credit spreads on the Fortis acquisition of UNS Energy?**

**A.** As discussed earlier in my testimony, rating agencies have typically considered acquisitions similar to the Fortis acquisition of UNS Energy to be credit positive, which frequently leads to a credit rating upgrade for the acquired company. Currently UNS Energy has a Baa3 credit rating from Moody's (generally equivalent to a BBB- credit

<sup>14</sup> Based on a 30-day average of the credit spread between the Moody's Baa and A rated utility bond indexes as of December 31, 2013.

1 rating from S&P), and Fortis is rated A- by S&P. Rating agencies have indicated that this  
2 transaction could be credit positive for UNS Energy and its subsidiary companies,  
3 assuming there are no detrimental conditions imposed by the regulatory agencies. It is  
4 reasonable to expect that an increase in credit rating for UNS Energy and its subsidiaries  
5 could result in a lower cost of debt.

6 **Q. What are your conclusions with regard to the analysis you have conducted**  
7 **comparing UNS Energy to the remaining electric IOUs?**

8 A. My primary conclusion is that the proposed acquisition of UNS Energy by Fortis would  
9 be consistent with the industry trend toward consolidation, and would result in a  
10 combined company that has more geographic diversification, a larger market  
11 capitalization, a larger customer base, and most likely result in a higher credit rating.  
12 Consequently, the merger should support improved access to financial markets for UNS  
13 Energy and its regulated utility subsidiaries, a possible credit upgrade for UNS Energy,  
14 TEP, UNS Electric, and UNS Gas and lower debt costs for UNS Energy's customers.

## **VII. BENEFITS TO CUSTOMERS FROM FORTIS ACQUISITION OF UNS ENERGY**

15 **Q. Please summarize the benefits of the merger for UNS Energy's customers.**

16 A. The companies have announced several benefits from the merger that will accrue directly  
17 to UNS Energy's customers, including the continuation of local operations and  
18 management, favorable merger cost treatment, and improved financial strength of UNS  
19 Energy as a subsidiary of Fortis.

20 **Q. How will the financial condition of UNS Energy change as a result of the acquisition**  
21 **by Fortis?**

22 A. As discussed previously, there are several financial benefits to UNS Energy that should  
23 result from being a subsidiary of a much larger electric utility holding company including  
24 access to capital on more favorable terms and lower borrowing costs. Rating agencies  
25 view the acquisition as credit positive for Tucson Electric Power, which may result in an  
26 upgrade of that UNS subsidiary company which should result in lower borrowing costs.



1 Further, a higher credit rating would have the long-term benefit of maintaining access to  
2 capital at lower costs in uncertain financial times, when credit spreads are exaggerated.

3 **Q. Why is it important that UNS Energy have access to capital?**

4 A. As discussed in the Joint Notice, UNS Energy needs to address several issues in the near  
5 future including: (1) sales growth that is lower than historical levels; (2) the need to  
6 balance generation portfolios with purchases of generation; (3) impacts of existing and  
7 anticipated environmental regulations; (4) innovations in the delivery of electric service;  
8 (5) integration of distributed generation in the utility grid; (6) increased cyber-security  
9 requirements; and (7) investing to enhance and expand the transmission network. All of  
10 these issues are in addition to the ongoing operating and maintenance requirements to  
11 maintain safe, reliable service for customers. UNS Energy has projected over \$1 billion  
12 in capital investments from 2014-2015 to meet these challenges. As a small, stand-alone  
13 utility, that capital plan would require financing from outside sources.

14 **Q. How will the acquisition be beneficial to UNS Energy's customers?**

15 A. The acquisition will be beneficial to UNS Energy's customers through the increased  
16 financial strength of Fortis. Fortis has committed to make an equity injection of \$200  
17 million into UNS Energy to strengthen its balance sheet and to help fund the acquisition  
18 of the Gila River Power Plant, a transaction that will reduce Tucson Electric Power's  
19 reliance on coal-fired power. In addition, UNS Energy will have the benefit of improved  
20 financial strength and access to the capital required to meet its financial obligations on  
21 more favorable terms than would be supported if UNS Energy remained a small, stand-  
22 alone utility. Financing the Company's substantial capital expenditure plan at a lower  
23 cost than could be achieved as a stand-alone utility will provide customers with a  
24 significant long-term financial benefit.

25 **Q. Does this conclude your testimony?**

26 A. Yes, it does.

**John J. Reed**  
**Chairman and Chief Executive Officer**

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John J. Reed is a financial and economic consultant with more than 35 years of experience in the energy industry. Mr. Reed has also been the CEO of an NASD member securities firm, and Co-CEO of the nation's largest publicly traded management consulting firm (NYSE: NCI). He has provided advisory services in the areas of mergers and acquisitions, asset divestitures and purchases, strategic planning, project finance, corporate valuation, energy market analysis, rate and regulatory matters and energy contract negotiations to clients across North and Central America. Mr. Reed's comprehensive experience includes the development and implementation of nuclear, fossil, and hydroelectric generation divestiture programs with an aggregate valuation in excess of \$20 billion. Mr. Reed has also provided expert testimony on financial and economic matters on more than 150 occasions before the FERC, Canadian regulatory agencies, state utility regulatory agencies, various state and federal courts, and before arbitration panels in the United States and Canada. After graduation from the Wharton School of the University of Pennsylvania, Mr. Reed joined Southern California Gas Company, where he worked in the regulatory and financial groups, leaving the firm as Chief Economist in 1981. He served as executive and consultant with Stone & Webster Management Consulting and R.J. Rudden Associates prior to forming REED Consulting Group (RCG) in 1988. RCG was acquired by Navigant Consulting in 1997, where Mr. Reed served as an executive until leaving Navigant to join Concentric as Chairman and Chief Executive Officer.

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## **REPRESENTATIVE PROJECT EXPERIENCE**

### **Executive Management**

As an executive-level consultant, worked with CEOs, CFOs, other senior officers, and Boards of Directors of many of North America's top electric and gas utilities, as well as with senior political leaders of the U.S. and Canada on numerous engagements over the past 25 years. Directed merger, acquisition, divestiture, and project development engagements for utilities, pipelines and electric generation companies, repositioned several electric and gas utilities as pure distributors through a series of regulatory, financial, and legislative initiatives, and helped to develop and execute several "roll-up" or market aggregation strategies for companies seeking to achieve substantial scale in energy distribution, generation, transmission, and marketing.

### **Financial and Economic Advisory Services**

Retained by many of the nation's leading energy companies and financial institutions for services relating to the purchase, sale or development of new enterprises. These projects included major new gas pipeline projects, gas storage projects, several non-utility generation projects, the purchase and sale of project development and gas marketing firms, and utility acquisitions. Specific services provided include the development of corporate expansion plans, review of acquisition candidates, establishment of divestiture standards, due diligence on acquisitions or financing, market entry or expansion studies, competitive assessments, project financing studies, and negotiations relating to these transactions.

### **Litigation Support and Expert Testimony**

Provided expert testimony on more than 150 occasions in administrative and civil proceedings on a wide range of energy and economic issues. Clients in these matters have included gas distribution utilities, gas pipelines, gas producers, oil producers, electric utilities, large energy consumers, governmental and regulatory agencies, trade associations, independent energy project developers, engineering firms, and gas and power marketers. Testimony has focused on issues ranging from broad regulatory and economic policy to virtually all elements of the utility ratemaking process. Also frequently testified regarding energy contract interpretation, accepted energy industry practices, horizontal and vertical market power, quantification of damages, and management prudence. Has been active in regulatory contract and litigation matters on virtually all interstate pipeline systems serving the U.S. Northeast, Mid-Atlantic, Midwest, and Pacific regions.

Also served on FERC Commissioner Terzic's Task Force on Competition, which conducted an industry-wide investigation into the levels of and means of encouraging competition in U.S. natural gas markets and served on a "Blue Ribbon" panel established by the Province of New Brunswick regarding the future of natural gas distribution service in that province.

### **Resource Procurement, Contracting and Analysis**

On behalf of gas distributors, gas pipelines, gas producers, electric utilities, and independent energy project developers, personally managed or participated in the negotiation, drafting, and regulatory support of hundreds of energy contracts, including the largest gas contracts in North America, electric contracts representing billions of dollars, pipeline and storage contracts, and facility leases.

These efforts have resulted in bringing large new energy projects to market across North America, the creation of hundreds of millions of dollars in savings through contract renegotiation, and the regulatory approval of a number of highly contested energy contracts.

### **Strategic Planning and Utility Restructuring**

Acted as a leading participant in the restructuring of the natural gas and electric utility industries over the past fifteen years, as an adviser to local distribution companies, pipelines, electric utilities, and independent energy project developers. In the recent past, provided services to most of the top 50 utilities and energy marketers across North America. Managed projects that frequently included the redevelopment of strategic plans, corporate reorganizations, the development of multi-year regulatory and legislative agendas, merger, acquisition and divestiture strategies, and the development of market entry strategies. Developed and supported merchant function exit strategies, marketing affiliate strategies, and detailed plans for the functional business units of many of North America's leading utilities.

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## **PROFESSIONAL HISTORY**

**Concentric Energy Advisors, Inc. (2002 - Present)**  
Chairman and Chief Executive Officer

**CE Capital Advisors (2004 - Present)**  
Chairman, President, and Chief Executive Officer

Navigant Consulting, Inc. (1997 - 2002)  
President, Navigant Energy Capital (2000 - 2002)  
Executive Director (2000 - 2002)  
Co-Chief Executive Officer, Vice Chairman (1999 - 2000)  
Executive Managing Director (1998 - 1999)  
President, REED Consulting Group, Inc. (1997 - 1998)

REED Consulting Group (1988 - 1997)  
Chairman, President and Chief Executive Officer

R.J. Rudden Associates, Inc. (1983 - 1988)  
Vice President

Stone & Webster Management Consultants, Inc. (1981 - 1983)  
Senior Consultant  
Consultant

Southern California Gas Company (1976 - 1981)  
Corporate Economist  
Financial Analyst  
Treasury Analyst

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## EDUCATION AND CERTIFICATION

B.S., Economics and Finance, Wharton School, University of Pennsylvania, 1976  
Licensed Securities Professional: NASD Series 7, 63, 24, 79 and 99 Licenses

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## BOARDS OF DIRECTORS (PAST AND PRESENT)

Concentric Energy Advisors, Inc.  
Navigant Consulting, Inc.  
Navigant Energy Capital  
Nukem, Inc.  
New England Gas Association  
R. J. Rudden Associates  
REED Consulting Group

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## AFFILIATIONS

American Gas Association  
Energy Bar Association  
Guild of Gas Managers  
International Association of Energy Economists  
National Association of Business Economists

New England Gas Association  
Society of Gas Lighters

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ARTICLES AND PUBLICATIONS

"Maximizing U.S. federal loan guarantees for new nuclear energy," *Bulletin of the Atomic Scientists*  
(with John C. Slocum), July 29, 2009

"Smart Decoupling - Dealing with unfunded mandates in performance-based ratemaking," *Public Utilities Fortnightly*, May 2012

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SPONSOR	DATE	CASE/APPLICANT	DOCKET NO.	SUBJECT
<b>Alberta Utilities Commission</b>				
Alberta Utilities (AltaLink, EPCOR, ATCO, ENMAX, FortisAlberta, Alta Gas)	1/13	Alberta Utilities	Application 1566373, Proceeding ID 20	Stranded Costs
<b>Arizona Corporation Commission</b>				
Tucson Electric Power	7/12	Tucson Electric Power	Docket No. E- 01933A-12-0291	Cost of Capital
<b>Fed'l Energy Regulatory Commission</b>				
Portland Natural Gas Transmission System	5/10, 3/11, 4/11	Portland Natural Gas Transmission System	Docket No. RP10-729- 000	Business risks; extraordinary and non- recurring events pertaining to discretionary revenues
Morris Energy	7/10	Morris Energy	Docket No. RP10-79- 000	Affidavit re: Impact of Preferential Rate
<b>Florida Public Service Commission</b>				
Florida Power and Light Co.	3/09	Florida Power & Light Co.	Docket No. 080677-EI	Benchmarking in support of ROE
Florida Power and Light Co.	3/09, 5/09, 8/09	Florida Power & Light Co.	Docket No. 090009-EI	New Nuclear cost recovery, prudence
Florida Power and Light Co.	3/10; 5/10, 8/10	Florida Power & Light Co.	Docket No. 100009-EI	New Nuclear cost recovery, prudence
Florida Power and Light Co.	3/11, 7/11	Florida Power & Light Co.	Docket No. 110009-EI	New Nuclear cost recovery, prudence



SPONSOR	DATE	CASE/APPLICANT	DOCKET NO.	SUBJECT
Florida Power and Light Co.	3/12 7/12	Florida Power & Light Co.	Docket No. 120009-EI	New Nuclear cost recovery, prudence
Florida Power and Light Co.	3/12 8/12	Florida Power & Light Co.	Docket No. 120015-EI	Benchmarking in support of ROE
Florida Power and Light Co.	3/13, 7/13	Florida Power & Light Co.	Docket No. 130009	New Nuclear cost recovery, prudence
Florida Senate Committee on Communication, Energy and Utilities				
Florida Power and Light Co.	2/09	Florida Power & Light Co.		Securitization
Mass. Department of Public Utilities				
NStar	9/07, 12/07	NStar, Bay State Gas, Fitchburg G&E, NE Gas, W. MA Electric	DPU 07-50	Decoupling, risk
Michigan Public Service Commission				
WE Energies	12/11	Wisconsin Electric Power Co	Case No. U-16830	Economic Benefits/Prudence
Consumer Energy Company	6/2013	Consumers Energy Company	Case No. U-17429	Certificate of Need, Integrated Resource Plan
Minnesota Public Utilities Commission				
Northern States Power	11/08, 05/09	Northern States Power Company	Docket No. E002/GR-08-1065	Return on Equity
Northern States Power	11/09 6/10	Northern States Power Company	Docket No. G002/GR-09-1153	Return on Equity
Northern States Power	11/10, 5/11	Northern States Power Company	Docket No. E002/GR-10-971	Return on Equity



SPONSOR	DATE	CASE/APPLICANT	DOCKET NO.	SUBJECT
<b>Missouri Public Service Commission</b>				
Missouri Gas Energy	11/10, 1/11	KCP&L	Case No. ER-2010-0355	Natural Gas DSM
Missouri Gas Energy	11/10, 1/11	KCP&L GMO	Case No. ER-2010-0356	Natural Gas DSM
Laclede Gas Company	5/11	Laclede Gas Company	Case No. CG-2011-0098	Affiliate Pricing Standards
Union Electric Company d/b/a Ameren Missouri	2/12, 8/12	Union Electric Company	Case. No. ER-2012-0166	ROE/earnings attrition/regulatory lag
<b>Nat. Energy Board of Canada</b>				
Maritimes & Northeast Pipeline	7/10	Maritimes & Northeast Pipeline	RH-4-2010	Regulatory policy, toll development
TransCanada Pipelines Ltd	9/11, 5/12	TransCanada Pipelines Ltd.	RH-3-2011	Business Services and Tolls Application
Trans Mountain Pipeline LLC	6/12, 1/13	Trans Mountain Pipeline LLC	RH-1-2012	Toll Design
TransCanada Pipelines Ltd	8/13	TransCanada Pipelines Ltd	RE-001-2013	Toll Design
<b>New Brunswick Energy and Utilities Board</b>				
Atlantic Wallboard/Flakeboard	09/09, 6/10, 7/10	Enbridge Gas New Brunswick	NBEUB 2009-017	Rate Setting for EGNB
<b>New Jersey Board of Public Utilities</b>				
Morris Energy Group	11/09	Public Service Electric & Gas	BPU GR 09050422	Discriminatory Rates
New Jersey American Water Co.	4/10	New Jersey American Water Co.	BPU WR 1040260	Tariff Rates and Revisions





SPONSOR	DATE	CASE/APPLICANT	DOCKET NO.	SUBJECT
Electric Customer Group	01/11	Generic Stakeholder Proceeding	BPU GR10100761 and ER10100762	Natural gas ratemaking standards and pricing
<b>New Mexico Public Service Commission</b>				
Southwestern Public Service Co., New Mexico	12/12	SPS New Mexico	Case No. 12-00350-UT	Rate Case, Return on Equity
<b>New York Public Service Commission</b>				
Rochester Gas and Electric and NY State Electric & Gas Corp	2/10	Rochester Gas & Electric NY State Electric & Gas Corp	Case No. 09-E-0715 Case No. 09-E-0716 Case No. 09-E-0717 Case No. 09-E-0718	Depreciation policy
<b>Nova Scotia Utility and Review Board</b>				
Nova Scotia Power	9/12	Nova Scotia Power	Docket No. P-893	Audit Reply
<b>Texas Public Utility Commission</b>				
Oncor Electric Delivery Company	10/08, 11/08	Oncor, TCC, TNC, ETT, LCRA TSC, Sharyland, STEC, TNMP	Docket No. 35665	Competitive Renewable Energy Zone
CenterPoint Energy	6/10 10/10	CenterPoint Energy/Houston Electric	Docket No. 38339	Regulatory policy, risk, consolidated taxes
Oncor Electric Delivery Company	1/11	Oncor Electric Delivery Company	Docket No. 38929	Regulatory policy, risk
Cross Texas Transmission	08/12 11/12	Cross Texas Transmission	Docket No. 40604	Return on Equity
Southwestern Public Service	11/12	Southwestern Public Service	Docket No. 40824	Return on Equity



SPONSOR	DATE	CASE/APPLICANT	DOCKET NO.	SUBJECT
<b>Texas Railroad Commission</b>				
Atmos Pipeline Texas	9/10; 1/11	Atmos Pipeline Texas	GUD 10000	Rate-making Policy, risk
<b>Texas State Legislature</b>				
CenterPoint Energy	4/13	Association of Electric Companies of Texas	SB 1364	Consolidated Tax Adjustment Clause Legislation
<b>Wisconsin Public Service Commission</b>				
Wisconsin Electric Power Company	10/09	Wisconsin Electric Power Co.	Docket No. 6630-CE-302	CPCN Application for wind project
Northern States Power Wisconsin	10/13	Xcel Energy (dba Northern States Power Wisconsin)	Docket No. 4220-UR-119	Fuel Cost Adjustments



SPONSOR	Date	CASE/APPLICANT	DOCKET NO.	SUBJECT
<b>American Arbitration Association</b>				
Sensata Technologies, Inc./EMS Engineered Materials Solutions, LLC	1/11	Sensata Technologies, Inc./EMS Engineered Materials Solutions, LLC v. Pepco Energy Services	Case No. 11-198-Y-00848-10	Change in usage dispute/damages
<b>State of Texas District Court of Nueces County</b>				
Northwestern National Insurance Company	11/11	ASARCO LLC	No. 01-2680-D	Damages
<b>U.S. Bankruptcy Court, No. District of New York</b>				
Cayuga Energy, NYSEG Solutions, The Energy Network	09/09	Cayuga Energy, NYSEG Solutions, The Energy Network	Case No. 06-60073-6-sdg	Going concern
<b>U.S. District Court, Northern District of Illinois, Eastern Division</b>				
U.S. Securities and Exchange Commission	4/12	U.S. Securities and Exchange Commission v. Thomas Fisher, Kathleen Halloran, and George Behrens	Case No. 07 C 4483	Prudence, PBR

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP- CHAIRMAN  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH



IN THE MATTER OF THE REORGANIZATION )  
OF UNS ENERGY CORPORATION )  
\_\_\_\_\_ )

DOCKET NO. E-04230A-14-0011  
E-01933A-14-0011

Direct Testimony of

BARRY V. PERRY

In Support of the Settlement Agreement

on Behalf of

Fortis Inc. and its Affiliates

June 2, 2014

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1 **I. INTRODUCTION**

2  
3 **Q. Please state your name and business address.**

4 A. My name is Barry V. Perry. I am the Vice President, Finance and Chief Financial  
5 Officer ("CFO") of Fortis Inc. ("Fortis"). My office address is The Fortis Building, Suite 1201,  
6 139 Water Street, St. John's, Newfoundland and Labrador, Canada.  
7

8 **Q. Are there any planned management changes at Fortis that will impact your role**  
9 **within the organization?**

10 A. Yes. On May 12, 2014, the President and Chief Executive Officer ("CEO") of Fortis,  
11 Mr. H. Stanley Marshall, announced his retirement effective December 31, 2014. On that same  
12 date, the Board of Directors of Fortis announced that I would succeed Mr. Marshall as President  
13 of Fortis effective June 30, 2014 and as CEO effective December 31, 2014.  
14

15 **Q. Have you previously submitted Direct Testimony in the proceeding?**

16 A. Yes. On January 24, 2014, I submitted Direct Testimony on behalf of Fortis and its  
17 Affiliates in conjunction with the Joint Notice of Intent to Reorganize<sup>1</sup> (the "Joint Notice") filed  
18 on January 10, 2014 in Docket Nos. E-04230A-14-0011 and E-01933A-14-0011 ("Docket").  
19

20 **Q. What is the purpose of your Testimony at this time?**

21 A. I will first summarize the business model, operating philosophy and financial condition  
22 of Fortis, including how the regulated utility subsidiaries of Fortis are managed, operated and  
23 financed on a standalone basis. I will also describe how the operating philosophy of Fortis,  
24

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25 <sup>1</sup> The Joint Notice of Intent to Reorganize pertains to the merger of Color Acquisition Sub Inc. ("Color  
26 Acquisition"), a wholly-owned subsidiary of FortisUS Inc. ("FortisUS"), with UNS Energy. FortisUS is a wholly-  
27 owned subsidiary of FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia"), which is a wholly-owned  
28 subsidiary of Fortis. UNS Energy is the parent company of UniSource Energy Services, Inc. ("UES"), Tucson  
Electric Power Company ("TEP"), UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS Gas") (TEP,  
UNS Electric and UNS Gas are referred to collectively as the "Regulated Utilities").

1 including its commitment to locally run utilities, is focused on employees, communities and  
2 customers. I will then explain how the Fortis philosophy will be applied to UNS Energy after  
3 the transaction closes and how that philosophy will enhance and improve UNS Energy's and the  
4 Regulated Utilities' ability to access capital on more favorable terms.

5 I will conclude my testimony with a discussion of the conditions Fortis agreed to in the  
6 Settlement Agreement dated May 16, 2014, which provide financial protection, regulatory  
7 transparency and community and customer commitments. These conditions collectively are  
8 consistent with the Fortis philosophy, beneficial to customers of the Regulated Utilities and in  
9 the public interest.

## 10 11 **II. BACKGROUND**

12  
13 **Q. Please provide an overview of Fortis and its business model and operating**  
14 **philosophy, as outlined in your Direct Testimony of January 24, 2014.**

15 A. Fortis is a utility holding company and is the largest investor-owned distribution utility  
16 company in Canada, providing regulated electricity and gas services to approximately 2.5  
17 million customers in New York State, five Canadian provinces and two Caribbean countries.  
18 The regulated utilities of Fortis account for approximately 90% of its total assets.

19 Fortis is a long-term investor in North American, regulated utilities. The long-term  
20 business objective of Fortis is to manage and grow its investment in regulated electric and gas  
21 utilities and to provide a framework for the provision of safe, reliable electricity and gas service  
22 to customers within the service territories of its regulated utility subsidiaries. The growth  
23 strategy of Fortis is principally based upon long-term organic growth in existing regulated utility  
24 operations where Fortis currently invests approximately C\$1 billion per year.<sup>2</sup> To complement  
25 this growth, and to diversify the risk of being concentrated in any one jurisdiction, Fortis  
26

27  
28 <sup>2</sup> C\$ signifies Canadian dollars.

1 pursues acquisitions of regulated utilities in the United States and Canada that fit the Fortis  
2 operating model.

3 Fortis believes that the effective management of regulated energy distribution systems  
4 requires local management and decision making. The regulated utilities of Fortis are governed,  
5 managed, operated and financed on a standalone basis. The operating philosophy of Fortis and  
6 its regulated utilities is to maintain strong relationships with their regulators and communities,  
7 provide a high level of customer service and maintain a strong financial position. The local  
8 management and board of directors of each of Fortis' utility subsidiaries are responsible for  
9 executing this operating philosophy.

10 Each of the principal regulated utilities of Fortis has its own board of directors. In the  
11 case of FortisBC Energy, FortisBC Electric, FortisAlberta, Maritime Electric, Newfoundland  
12 Power, Central Hudson Gas & Electric and Caribbean Utilities, the majority of the directors are  
13 independent and most reside in the jurisdiction served by the utility.<sup>3</sup>

14 Each Fortis regulated utility also has its own senior management team that lives in the  
15 area served by the utility and stands accountable to that utility's own board of directors.  
16 Within the Fortis group, management focus and accountability are reinforced through effective  
17 corporate governance. For example, each utility's senior management team is required to report  
18 to its board of directors on the key aspects of utility operations such as safety, customer  
19 satisfaction, service continuity, environmental compliance, cost management and financial  
20 performance. The senior management team also serves as the direct contact and decision  
21 making authority in all regulatory matters.

22 Each Fortis regulated utility has the physical, financial and human resources required to  
23 discharge its obligation to provide safe, reliable service. There is no shared services company  
24 within the Fortis group. Fortis utilities are encouraged to share best operating practices through  
25 collaboration with other utilities within the group where practical. In this regard, each of  
26

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27 <sup>3</sup> The small regulated utilities of Fortis in Ontario and in the Turks and Caicos Islands do not have independent  
28 boards.



1 the utility boards of directors typically includes at least one CEO from an affiliated  
2 regulated utility, which helps in the sharing of best practices.

3 Fortis is respectful of regulatory oversight and believes that responsiveness to, and  
4 cooperation with, regulators is critical to successful utility operations and the overall success of  
5 the enterprise. Fortis has met every commitment it has made to a regulatory body in the course  
6 of seeking, and subsequent to obtaining, approval to acquire a public utility. It is a key  
7 expectation of Fortis that local management deal respectfully and responsively with local  
8 regulators. This expectation is a cornerstone of the Fortis standalone operating philosophy.

9 Fortis also believes that public utilities should be key contributors to the economic  
10 development and well-being of the communities they serve. In 2013, Fortis companies  
11 contributed in total approximately C\$6 million in sponsorships and in-kind donations to local  
12 charitable causes. Employee volunteer efforts are also encouraged, supported and recognized.

13  
14 **Q. Please describe the financial condition of Fortis.**

15 A. The financial position of Fortis is strong and stable. Fortis is the largest investor-owned  
16 electric and gas distribution utility in Canada with total assets of approximately C\$18.6 billion  
17 as of March 31, 2014, and fiscal 2013 revenues exceeding C\$4.0 billion. In 2013, Fortis had  
18 cash flow from operations of approximately C\$900 million and earnings of C\$420 million.

19 Fortis has consolidated committed credit facilities of approximately C\$2.7 billion, of  
20 which C\$2.4 billion was undrawn as of March 31, 2014. The consolidated facilities include a  
21 C\$1.0 billion facility at Fortis.

22 Since the beginning of 2013, Fortis has raised approximately \$3.3 billion in the capital  
23 markets, which attests to investors' confidence in our business strategy.

24  
25 **Q. Are the common shares of Fortis publicly traded?**

26 A. Yes. The common shares of Fortis are traded on the Toronto Stock Exchange under the  
27 ticker symbol "FTS" with a current market capitalization of approximately C\$7.0 billion. The  
28

1 current enterprise value of Fortis, which includes common and preferred equity and debt, is in  
2 excess of C\$16 billion.

3 The common shares of Fortis are widely held with the majority (approximately 60-70%)  
4 being held by a diverse group of retail shareholders. No single shareholder owns, controls or  
5 directs more than 10% of Fortis' issued and outstanding common shares.

6 As a publicly traded company in Canada, Fortis is subject to financial reporting and  
7 continuous disclosure requirements which have been established by the Canadian Securities  
8 Administrators ("CSA"), and which are substantially similar to those of the Securities and  
9 Exchange Commission in the United States ("SEC"). These similar disclosure requirements  
10 effectively ensure that Fortis meets a standard with respect to public reporting and transparency  
11 that is consistent with the SEC standard. The SEC and CSA have adopted a Multijurisdictional  
12 Disclosure System which permits eligible Canadian and U.S. issuers to raise capital in cross-  
13 border public financings, conduct various cross-border M&A transactions and make continuous  
14 disclosure filings while complying primarily with their home country securities regulations,  
15 including disclosure and procedural rules.

16  
17 **Q. How is Fortis rated by credit rating agencies?**

18 A. Fortis has one of the highest credit ratings among utility holding companies in North  
19 America. This is evidence of its strong financial standing and stable risk profile. Fortis has an  
20 A- credit rating by Standard & Poor's ("S&P") and an A(low) rating by Dominion Bond Rating  
21 Service ("DBRS"). The ratings categories and methodologies of S&P, DBRS, Moody's  
22 Investor Services ("Moody's") and Fitch Ratings ("Fitch") are substantially similar.

23 As described in my Direct Testimony of January 24, 2014, a substantial portion of the  
24 financing required to complete the acquisition of UNS Energy has already been secured. When  
25 Fortis announced its proposed acquisition of UNS Energy, we also announced the offering of  
26 C\$1.8 billion of convertible debentures as part of our plan to finance the acquisition. These  
27 debentures are convertible to common equity of Fortis once all regulatory and governmental  
28

1 approvals required to finalize the acquisition have been obtained and all other outstanding  
2 conditions under the Merger Agreement have been fulfilled or waived. Given that convertible  
3 debentures are treated as debt by S&P, the agency revised its outlook on Fortis on December  
4 13, 2013 from "Stable" to "Negative", while at the same time affirming Fortis' A- credit rating.  
5 Actions of this nature are not unusual by credit rating agencies when an announced acquisition  
6 is subject to the execution of long-term financing plans. The action taken by S&P in this case is  
7 similar to their action in 2012 when Fortis announced its plans to acquire CH Energy Group,  
8 Inc.<sup>4</sup> S&P has stated that, "An outlook revision to stable would likely occur when the  
9 convertible debentures are converted to equity, lessening the debt burden." This is expected to  
10 occur immediately after closing of the merger transaction.

11 On December 11, 2013, following the announced acquisition of UNS Energy by Fortis,  
12 DBRS issued a press release placing the ratings of Fortis under review with developing  
13 implications. DBRS based its ratings action on uncertainty with respect to how Fortis plans to  
14 finance the acquisition. DBRS indicated that it will further review the financing plan once it is  
15 finalized and is expected to issue a further ratings update at that time. Once again, this is  
16 similar to the action taken by DBRS in 2012 when Fortis announced its plans to acquire CH  
17 Energy Group, Inc.<sup>5</sup>

18  
19 **Q. How are the regulated utility subsidiaries of Fortis financed?**

20 A. Each Fortis regulated utility is financed on a standalone basis, and has both standalone  
21 credit facilities and senior long-term debt instruments. These utility financing arrangements do  
22 not permit lending or guarantees to Fortis or other affiliates. Each of FortisBC Energy, FortisBC  
23

---

24 <sup>4</sup> When Fortis announced its intension to acquire CH Energy Group, Inc. in February 2012, S&P's outlook on the  
25 credit rating of Fortis was placed on "credit watch with negative implications". In May 2012, Once Fortis put its  
26 acquisition plan in place, including the issuance of common equity; S&P returned its outlook on Fortis to "Stable".

27 <sup>5</sup> When Fortis announced its intension to acquire CH Energy Group, Inc. in February 2012, DBRS placed the credit  
28 rating of Fortis "under review with developing implications". In mid-2012, after Fortis had put its acquisition plan  
in place, including the issuance of common equity; DBRS affirmed Fortis' A(low) credit rating and removed it  
from "under review with developing implications".

1 Electric, FortisAlberta, Central Hudson Gas & Electric and Newfoundland Power maintain  
2 standalone, investment grade credit ratings with at least two nationally recognized rating  
3 agencies.  
4

5 **Q. How are the regulated utility subsidiaries of Fortis rated by credit rating agencies?**

6 A. Exhibit BVP-2 to my Direct Testimony of January 24, 2014 provides the credit  
7 ratings of the rated companies within the Fortis group as of that date.<sup>6</sup> The principal regulated  
8 utilities of Fortis all carry a rating that is superior to the credit ratings of UNS Energy, TEP,  
9 UNS Electric and UNS Gas.  
10

11 **Q. Why does Fortis wish to complete this acquisition of UNS Energy?**

12 A. The acquisition of UNS Energy is consistent with our long-term business strategy of  
13 owning well-run North American regulated electric and gas utilities. Fortis believes it is making  
14 a sound long-term investment in Arizona and in UNS Energy.  
15

16 The Regulated Utilities are well-run, with a strong UNS Energy management team,  
17 dedicated employees, and well-maintained plant and equipment. Fortis believes the economy in  
18 Arizona, which is similar in size to the economy of the Province of British Columbia, will  
19 continue to outperform other U.S. jurisdictions; thereby providing Fortis with opportunities for  
20 capital investment in the Regulated Utilities to meet the future needs of their customers.  
21 Moreover, UNS Energy's utility operations and regulatory environment are similar to those of  
22 the Fortis Canadian and New York utilities.

23 The Regulated Utilities will increase the overall size of Fortis by approximately 30% and  
24 provide Fortis with greater geographical diversity in its portfolio of regulated electric and gas  
25 utilities.  
26

27  
28 <sup>6</sup> Moody's upgraded its rating of Central Hudson Gas & Electric on January 30, 2014 from A3 to A2.

1       **Q.     How will UNS Energy operate under Fortis ownership?**

2       A.     Just as it does today, UNS Energy and the Regulated Utilities will continue to focus  
3       on providing safe, reliable and cost-effective service to their customers. As part of the  
4       Fortis group of regulated utilities, UNS Energy will continue to be operated, managed and  
5       governed locally and shall maintain its headquarters in Tucson, Arizona. Fortis expects that  
6       UNS Energy's current officers will continue as the officers of UNS Energy after the acquisition;  
7       and Fortis will, within one year, appoint a UNS Energy Board of Directors with oversight over  
8       UNS Energy and the Regulated Utilities, a majority of whom shall be independent and a  
9       majority of whom shall be residents of Arizona.<sup>7</sup> All decisions with respect to the  
10      operations of UNS Energy and the Regulated Utilities will be made by the local  
11      management and independent Board of Directors. These decisions will include, but will  
12      not be limited to: capital and operating plans; establishment of dividend policy (consistent  
13      with the Settlement Agreement); determination of debt and equity requirements; employment  
14      levels, union negotiations and relationships, and hiring practices; the design and delivery of  
15      low income, energy efficiency and renewable energy programs; and community  
16      involvement. Local management will also continue to represent the Regulated Utilities in  
17      all future regulatory matters. This expectation is a cornerstone of the Fortis standalone  
18      operating philosophy.

19           UNS Energy will also enjoy improved access to capital on more favorable terms as  
20      part of the Fortis group. Also, as part of a federation of well-run North American electric  
21      and gas utilities, UNS Energy will be able to draw upon expanded technical, operational,  
22      financial and regulatory expertise while remaining a strong, locally-based utility. While this  
23      is not a synergy driven transaction, any cost savings from realized synergies that result from the  
24      acquisition and that are directly attributable to the Regulated Utilities, including but not limited  
25      

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26           <sup>7</sup> As part of the transition to a new board of directors, and as referred to in Sections 1.1(c) and 5.14(c) of the  
27      Agreement and Plan of Merger, four (4) UNS Energy board members as of the date of closing will remain  
28      members of the UNS Energy Board of Directors following the close.

1 to reduced or eliminated public company costs and reduced insurance costs, which are  
2 anticipated, will be beneficial to customers in future rate cases.  
3

4 **Q. How do the credit rating agencies view the impact of the acquisition on their**  
5 **ratings of UNS Energy and the Regulated Utilities?**

6 A. As discussed in Mr. Hutchens' testimony, and as further described in my Direct  
7 Testimony of January 24, 2014, following the announced acquisition of UNS Energy by Fortis,  
8 each of the three credit rating agencies who rate TEP (S&P, Fitch and Moody's)  
9 commented positively on the rating outlook for TEP following the acquisition. Although  
10 there is no guarantee that any of the rating agencies will actually upgrade the credit rating of  
11 UNS Energy or TEP following the acquisition, the noted rating agencies' comments reflect their  
12 view of the strength of Fortis' financial profile. Further, they confirm that the acquisition is  
13 expected to improve the financial status of UNS Energy and the Regulated Utilities and  
14 improve their access to capital on more favorable terms.  
15

16 **III. SETTLEMENT BENEFITS**  
17

18 **Q. What was the extent of your involvement in arriving at a Settlement Agreement?**

19 A. Mr. Hutchens describes the settlement process in some detail in his Direct Testimony.  
20 As for my involvement, I personally met with Commission Utilities Division Staff ("Staff") and  
21 with representatives from the Residential Utility Consumer Office ("RUCO") prior to the  
22 submission of my Direct Testimony on January 24, 2014. Before settlement discussions began,  
23 I read the testimony filed in this Docket on April 30, 2014 by Staff, RUCO and the various  
24 other intervenors to familiarize myself with their issues and the suggested approval conditions  
25 put forth by the various parties. I, then, personally represented Fortis at the settlement  
26 discussions which took place in Phoenix, Arizona on May 5, 2014.  
27  
28

1 **Q. What effect does the Settlement Agreement have on the 24 conditions offered in the**  
2 **Joint Notice?**

3 A. The approval conditions contained in the Settlement Agreement include, and build upon,  
4 the 24 conditions that were contained in the Joint Notice. Several of the original conditions  
5 have now been enhanced to provide greater clarity with respect to, or to strengthen, the  
6 commitments made by the Joint Applicants. Others, such as: the commitment to provide direct,  
7 tangible customer benefits by way of bill credits; the commitment by Fortis to provide an  
8 increased equity injection on closing; the commitment to establish a "golden share"; and, the  
9 commitment to provide "follow-on merger savings" that are reasonably applicable to the  
10 Regulated Utilities and their customers have been added based primarily on the testimony and  
11 recommended conditions of Staff and RUCO. The additional conditions provide significant  
12 enhancements that overwhelmingly ensure that the merger transaction is in the public interest.  
13

14 **Q. Why does Fortis support the Settlement Agreement?**

15 A. The terms of the Settlement Agreement provide a just and reasonable resolution of the  
16 issues arising in this Docket and, among other things, establish appropriate conditions to ensure  
17 that quality of service by the Regulated Utilities is maintained, that access to capital for UNS  
18 Energy and the Regulated Utilities will be improved, and that unnecessary litigation expense  
19 and delay can be avoided.

20 The Settlement Agreement balances the interests of the parties involved and the  
21 different perspectives brought forward by the various intervenors; preserves the standalone  
22 nature of UNS Energy and the Regulated Utilities; meets the requirements for Commission  
23 approval of the reorganization of UNS Energy under A.A.C. R14-2-803; and, in addition,  
24 provides tangible customer benefits over and above those required by Arizona law.  
25  
26  
27  
28

1 **Q. Is Fortis still committed to its plans with respect to the acquisition and operation of**  
2 **UNS Energy and the Regulated Utilities in light of the additional and enhanced conditions**  
3 **contained in the Settlement Agreement?**

4 A. Yes. Fortis looks upon this merger transaction with a long-term view, consistent with  
5 our long-term business strategy of owning well-run North American regulated electric and gas  
6 utilities. UNS Energy and the Regulated Utilities are well-run; operate within a regulatory  
7 environment that is similar to those of Fortis' Canadian and New York utilities; and provide  
8 Fortis with greater geographical diversification and opportunities for long-term capital  
9 investment in a growing Arizona economy.

10 The additional and enhanced conditions contained in the Settlement Agreement provide  
11 support for, and are consistent with, the Fortis standalone utility operating philosophy; and  
12 reinforce the commitments initially proposed by Fortis and UNS Energy in the Joint Notice.

13 As a new entrant into the Arizona business community, Fortis recognizes that it must  
14 prove to the Commission that it is well qualified as an owner of the Regulated Utilities. Fortis  
15 stands by its record and its intentions with respect to the ownership and operation of UNS  
16 Energy and the Regulated Utilities. Fortis has delivered on every commitment it has made to a  
17 regulatory body in the course of seeking, and subsequent to obtaining, approval to acquire a  
18 public utility. And, as referred to in my Direct Testimony of January 24, 2014, the Fortis  
19 approach to ownership of regulated utilities has been favorably acknowledged by regulators in  
20 several of the jurisdictions in which Fortis currently operates.

21  
22 **IV. SETTLEMENT CONDITIONS**

23  
24 **Q. Please comment on the conditions in the Settlement Agreement that more**  
25 **specifically impact Fortis.**

26 A. The 66 conditions contained in the Settlement Agreement ("Settlement Conditions") are  
27 categorized as Customer Benefits & Protections, Credit Quality and Capital Requirements,  
28



1 Quality of Service, Customer Programs, Corporate Governance, Financial Transparency and  
2 Reporting Requirements, Acknowledgement of Arizona Laws & Procedures, and  
3 Miscellaneous. Mr. Hutchens' Direct Testimony will address those Settlement Conditions that  
4 are pertinent to the local management of UNS Energy and the Regulated Utilities. I will  
5 comment on the Settlement Conditions that specifically impact or place specific commitments  
6 on Fortis upon, and subsequent to, its acquisition of UNS Energy.  
7

### 8 *Customer Benefits & Protections*

9 Fortis and UNS Energy have agreed to fund \$30 million in tangible customer benefits  
10 which, in accordance with the Settlement Agreement, will be provided to customers of the  
11 Regulated Utilities by way of bill credits over 5 years, commencing October 1, 2014. The total  
12 bill credits of \$30 million ensure that customers receive immediate benefits as a result of the  
13 merger transaction. Fortis and UNS Energy intend to fund these tangible customer benefits  
14 upon closing of the merger transaction.

15 In the Joint Notice, Fortis had committed to an equity infusion of \$200 million into UNS  
16 Energy for the benefit of UNS Energy and the Regulated Utilities upon closing of the  
17 transaction. Fortis has agreed, in the Settlement Agreement, to increase the equity infusion  
18 upon closing to \$220 million. Fortis and UNS Energy have also committed to not seek any  
19 recovery of the acquisition premium or goodwill associated with the merger transaction, nor to  
20 seek any recovery of acquisition related costs including change of control or retention  
21 payments, or shareholder litigation costs, related to the merger.  
22

### 23 *Credit Quality and Capital Requirements*

24 Fortis and UNS Energy have agreed to limit dividends paid by the Regulated Utilities to  
25 UNS Energy to 60 percent of annual earnings for a period of 5 years or until such time as the  
26 respective Regulated Utility's equity capitalization reaches 50 percent of total capital,  
27 whichever is earlier. This agreed upon commitment, together with the equity funding referred  
28

1 to above and other agreed upon credit quality and capital requirement conditions included in the  
2 Settlement Agreement, is expected to increase equity in the Regulated Utilities to 50 percent of  
3 total capital within an estimated 3 to 5 years; and will, therefore, help strengthen the financial  
4 status of the Regulated Utilities, and provide them with the equity required to meet their future  
5 capital needs.

6  
7 *Quality of Service*

8 In the Joint Notice, Fortis and UNS Energy committed to maintaining the current level  
9 of employees of the Regulated Utilities for a period of 2 years subject to changes in the ordinary  
10 course of business. This commitment is extended to 4 years in the Settlement Agreement. This  
11 commitment recognizes the importance of maintaining a knowledgeable and capable workforce  
12 in order to continue the delivery of safe and reliable service to customers of the Regulated  
13 Utilities.

14  
15 *Corporate Governance and Financial Transparency and Reporting*

16 Commitments made by Fortis in the Joint Notice, and which have been expanded upon  
17 in the Settlement Agreement, with respect to corporate governance and financial transparency  
18 and reporting are consistent with and reflect the standalone operating philosophy employed by  
19 Fortis in its ownership of regulated electric and gas utilities. The Settlement Conditions with  
20 respect to ring fencing, the appointment of a majority of local and independent board of  
21 directors, the establishment of a "golden share", maintaining UNS Energy's corporate  
22 headquarters in Tucson, Arizona, and maintaining UNS Energy's local management and  
23 operations with responsibility for all day-to-day operations of the Regulated Utilities provide  
24 that customers are protected and financially separated from Fortis and its other utility  
25 operations. Local governance, management and operation of the Regulated Utilities also  
26 provides that customers continue to be served by a utility that is positioned to understand the  
27  
28

1 assets, operations, customer service expectations and applicable regulatory framework within  
2 the Arizona jurisdiction.

3 Similarly, Settlement Conditions which provide the Commission with regular status  
4 reports, access to Fortis books and records, rules governing affiliate transactions and  
5 relationships, and access to senior management of Fortis, if required; and which acknowledge  
6 the Commission's authority to regulate the Regulated Utilities, help to ensure that regulatory  
7 oversight and transparency is maintained following the merger.

8  
9 *Acknowledgement of Arizona Laws & Procedures*

10 Fortis acknowledges the Commission's jurisdiction over the Regulated Utilities and will  
11 comply with applicable Arizona and federal statutes and Commission rules including, without  
12 limitation, the affiliated interest rules as set forth in the Arizona Administrative Code.

13  
14 *Committed for the Long-Term*

15 While Fortis is a long-term investor in regulated electric and gas utilities, as  
16 demonstrated by the fact that it has never sold a utility subsidiary, Fortis has specifically  
17 committed to not sell or transfer ownership of UNS Energy or any of the Regulated Utilities for  
18 a period of at least 5 years. Fortis also acknowledges that any such sale or transfer after 5 years  
19 would require advance Commission approval.

20  
21 **V. OTHER REQUIRED APPROVALS**

22  
23 **Q. What is the status of other approvals that are required prior to closing the merger**  
24 **transaction?**

25 **A.** Since the merger transaction was announced on December 11, 2013, approval of the  
26 transaction has been obtained from UNS Energy shareholders<sup>8</sup>, the Federal Energy Regulatory

27  
28 <sup>8</sup> See eDocket E-04230A-14-0011 image 0000152050.

1 Commission<sup>9</sup>, and the Committee on Foreign Investment in the United States<sup>10</sup>. In addition to  
2 approval by the Commission, completion of the merger transaction remains subject to the  
3 expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust  
4 Improvements Act of 1976, as amended, ("Hart-Scott-Rodino") and the satisfaction of other  
5 customary closing conditions.

6  
7 **Q. What is the anticipated timeline with respect to the Hart-Scott-Rodino approval?**

8 A. Fortis and UNS Energy filed the required Hart-Scott-Rodino notification with the Federal  
9 Trade Commission and the Department of Justice on May 30, 2014. If the initial 30-day waiting  
10 period expires without a challenge or request for additional information, then the Hart-Scott-  
11 Rodino approval will become effective by June 30, 2014. If a request for additional information  
12 is received, an additional 30-day waiting period will commence once Fortis and UNS Energy  
13 substantially comply with the information request.

14  
15 **VI. CONCLUSION**

16  
17 **Q. In conclusion, will the acquisition of UNS Energy by Fortis and the commitments**  
18 **agreed to in the Settlement Agreement benefit customers, employees and the communities**  
19 **that UNS Energy serves?**

20 A. Yes.

21  
22  
23  
24  
25  
26  
27 <sup>9</sup> See eDocket E-04230A-14-0011 image 0000152246.

28 <sup>10</sup> See eDocket E-04230A-14-0011 image 0000153507.

1 **Q. Will approval of the Merger Transaction, subject to the conditions of the**  
2 **Settlement Agreement, improve the financial status of UNS Energy and the Regulated**  
3 **Utilities, improve their access to capital at more reasonable terms, and enhance the ability**  
4 **of the Regulated Utilities to continue providing safe, reasonable and adequate service to**  
5 **their customers?**

6 A. Yes.  
7

8 **Q. Do you have any concluding remarks?**

9 A. Yes. I would first of all like to thank the parties who participated in what has been an  
10 open and transparent settlement process. This Settlement Agreement is in the public interest as  
11 it balances the interests of UNS Energy, the Regulated Utilities and the communities they serve,  
12 their customers and employees, and Fortis. The Settlement Agreement and associated merger  
13 transaction provide substantial and material benefits including, but not limited to, immediate  
14 and direct tangible customer benefits by way of bill credits over 5 years, the financial  
15 strengthening of UNS Energy and the Regulated Utilities, and benefits to employees and the  
16 communities served by the Regulated Utilities.

17 Upon closing of this merger transaction, UNS Energy will join the Fortis federation of  
18 regulated utilities and become part of a larger, more diverse and financially secure company  
19 with a stronger credit rating and improved access to capital, on more favorable terms.  
20 Ultimately, this will be beneficial to the Regulated Utilities and their customers. Commission  
21 approval of this acquisition, subject to the conditions of the Settlement Agreement, is just,  
22 reasonable and in the public interest.  
23

24 **Q. Does this conclude your testimony?**

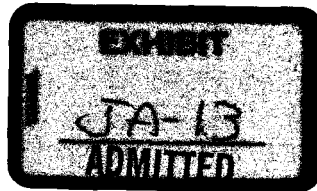
25 A. Yes.  
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**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS**  
BOB STUMP, CHAIRMAN  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH

IN THE MATTER OF THE ) DOCKET NO. E-04230A-14-0011  
REORGANIZATION OF UNS ENERGY ) DOCKET NO. E-01933A-14-0011  
CORPORATION )  
\_\_\_\_\_ )



Direct Testimony of  
  
David G. Hutchens  
  
In Support of Settlement Agreement  
  
on Behalf of  
  
UNS Energy Corporation and its Affiliates

June 2, 2014

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### Exhibits

DGH-3          Settlement Agreement Ratepayer Credits

1 **I. INTRODUCTION.**

2  
3 **Q. Please state your name and business address.**

4 A. My name is David G. Hutchens. My business address is 88 East Broadway Blvd.,  
5 Tucson, Arizona 85701.  
6

7 **Q. Have you previously submitted Direct Testimony in this proceeding?**

8 A. Yes. I submitted Direct Testimony on January 24, 2014 in support of the Joint Notice of  
9 Intent to Reorganize ("Joint Notice") that was filed on January 10, 2014 in Docket Nos.  
10 E-04230A-14-0011 and E-01933A-14-0011 ("Docket").  
11

12 **Q. Have there been management changes at UNS Energy Corporation ("UNS Energy")**  
13 **since the Direct Testimony was filed on January 24, 2014?**

14 A. Yes. Paul Bonavia (who also submitted testimony on January 24, 2014) has stepped  
15 down as Chief Executive Officer of UNS Energy. He now serves as Executive Board  
16 Chair of UNS Energy. I am now Chief Executive Officer and President of UNS Energy,  
17 Tucson Electric Power Company ("TEP"), UniSource Energy Services, Inc. ("UES"),  
18 UNS Electric, Inc. ("UNS Electric"), and UNS Gas, Inc. ("UNS Gas") (TEP, UNS  
19 Electric and UNS Gas will be referred to collectively as the "Regulated Utilities").  
20

21 **Q. Have there been any other developments since the filing of the Joint Notice?**

22 A. Yes. Approvals for the merger transaction have been obtained from UNS Energy  
23 shareholders, the Federal Energy Regulatory Commission, and the Committee on Foreign  
24 Investment in the United States.  
25  
26  
27



1 **Q. What is the purpose of your Testimony?**

2 A. The purpose of my Testimony is to support the May 16, 2014 Settlement Agreement  
3 ("Settlement Agreement") that was filed with the Arizona Corporation Commission  
4 ("Commission") in this Docket. In this Testimony, I will: (i) provide background on the  
5 proposed transaction and an overview of the Settlement Agreement, (ii) discuss the  
6 settlement process and UNS Energy's support for the Settlement Agreement, and (iii)  
7 provide an overview of the Settlement Agreement's key provisions.

8  
9 I will further explain how the order issued in this Docket will replace the conditions that  
10 the Commission adopted in Decision No. 60480 (November 25, 1997), which is the order  
11 that created TEP's holding company, UniSource Energy Corporation (now UNS Energy)  
12 ("1997 TEP Holding Company Order").

13  
14 Finally, I discuss why UNS Energy and the Regulated Utilities believe the Settlement  
15 Agreement should be approved under the three standards set forth in Arizona  
16 Administrative Code R14-2-803(C) and why approval of the acquisition, subject to the 66  
17 conditions in the Settlement Agreement, is in the public interest.

18  
19 **II. BACKGROUND AND SUMMARY.**

20  
21 **A. Overview of the Fortis/UNS Energy Transaction.**

22  
23 **Q. Please describe the proposed transaction between Fortis and UNS Energy.**

24 A. The proposed transaction was described in detail in the Direct Testimony filed by the  
25 Joint Applicants. I will provide an overview to put the Settlement Agreement in context.  
26 Upon completion of the acquisition, UNS Energy will cease being a publicly traded  
27 company, with Fortis becoming the ultimate parent company of UNS Energy, UES, and

1 the Regulated Utilities. Fortis is, and will remain, a publicly traded company.

2  
3 Fortis is well-qualified to be the ultimate parent of the Regulated Utilities. It has a long  
4 track record in the ownership of well-run regulated electric and gas utilities. The  
5 cornerstone of its operating philosophy is that its utility subsidiaries should be managed  
6 at the local level on a standalone basis. Consistent with Fortis' philosophy, the  
7 acquisition will allow UNS Energy to build upon and preserve the local character and  
8 strengths of the Regulated Utilities while providing them with improved access to debt  
9 and equity capital based on the financial strength of Fortis.

10  
11 Through its wholly-owned subsidiaries, Fortis is the largest investor-owned electric and  
12 gas distribution utility in Canada. It provides gas and electric service to approximately  
13 2.5 million customers through utility subsidiaries in Canada, New York State and the  
14 Caribbean. Fortis has total assets exceeding C\$18.6 billion<sup>1</sup>, and a market capitalization  
15 of C\$7.0 billion compared with UNS Energy's total assets of US\$4.5 billion and a market  
16 capitalization of approximately US\$2 billion before the announcement of the proposed  
17 acquisition.

18  
19 Additional information about Fortis, its operating philosophy and its financial strength is  
20 included in the Direct Testimonies of H. Stanley Marshall and Barry V. Perry.

21  
22 **Q. Why is the financial strength of Fortis important to the Regulated Utilities and their**  
23 **customers?**

24 **A.** As explained in greater detail in the Joint Applicants' Direct Testimonies, the acquisition  
25 will improve UNS Energy's access to debt and equity capital. For the Regulated Utilities  
26 and their customers, access to capital is especially important because the companies

27  

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<sup>1</sup> C\$ signifies Canadian dollars.

1 anticipate making \$2 billion in capital expenditures over the next five years in order to  
2 maintain safe, reliable service to our customers. Approximately half of these capital  
3 expenditures will be made over the next two years, including the following significant  
4 investments in generation:

- 5 • TEP's and UNS Electric's \$219 million purchase of Gila River Unit 3,  
6 anticipated to close in December 2014;
- 7 • TEP's \$65 million purchase of a 35% interest in Unit 1 of the Springerville  
8 Generating Station ("SGS"), anticipated to close in December 2014 and  
9 January 2015; and
- 10 • TEP's \$73 million purchase of SGS fuel handling facilities, anticipated to  
11 close in April 2015.

12  
13 **Q. How will the acquisition affect the quality of service to your customers?**

14 **A.** Our customers will continue to receive safe and reliable service from the Regulated  
15 Utilities. The Settlement Agreement includes specific conditions to protect quality of  
16 service. Moreover, our improved access to capital resulting from this transaction will  
17 help us make the investments needed to continue to provide safe, reliable and cost-  
18 effective service to our customers.

19  
20 **Q. How will the acquisition impact rates charged to customers?**

21 **A.** Aside from the bill credits that will be given to the Regulated Utilities' customers as  
22 discussed later in my testimony, the rates approved in the most recent rate orders for each  
23 of the Regulated Utilities will remain in effect until such time as the Commission  
24 approves new rates. Regarding future rate cases, the Regulated Utilities will likely have a  
25 lower cost of debt than they would without the transaction due to the expected credit  
26  
27

1 ratings upgrades.<sup>2</sup> As a result of future improved credit ratings, future rates for the  
2 Regulated Utilities are expected to be lower with approval of the acquisition than they  
3 would be otherwise, thus providing a substantial benefit to customers' rates.  
4

5 **B. Summary of the Settlement Agreement.**  
6

7 **Q. Please summarize the terms and provisions included in the Settlement Agreement.**

8 A. The Settlement Agreement is very straightforward. First, Signatories to the Settlement  
9 Agreement agree that, subject to the conditions contained therein, approval of the  
10 acquisition serves the public interest and does not impair UNS Energy or the Regulated  
11 Utilities in any way. The Settlement Agreement includes 66 conditions ("Settlement  
12 Conditions") that include and expand upon the conditions proposed by the Joint  
13 Applicants in the Joint Notice. The Settlement Conditions provide substantial benefits  
14 and protections for customers of the Regulated Utilities, including:

- 15 • customer credits of \$30 million spread over 5 years, including \$10 million of  
16 credits in the first year;
- 17 • an immediate equity infusion of \$220 million into the Regulated Utilities;
- 18 • protections against any adverse rate impact from the costs of the acquisition;
- 19 • credit quality and capital structure provisions;
- 20 • support of existing levels of contributions to charitable and community  
21 programs;
- 22 • maintenance of existing low-income customer assistance programs;
- 23 • maintenance of existing employment and employee benefit levels for a period  
24 of at least four years after the conclusion of the acquisition;
- 25 • maintenance of the existing local management of UNS Energy and the  
26

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27 <sup>2</sup> As discussed in the Direct Testimony of Kevin Larson filed on January 24,, 2014, S&P and Fitch Ratings Inc. indicated that TEP's ratings could be raised by one notch if the acquisition is approved, while Moody's acknowledged the benefit of joining an established utility company of Fortis' size and scope.

1 Regulated Utilities and their control over operations;

- 2 • maintenance of the headquarters of UNS Energy and the Regulated Utilities in  
3 Tucson;
- 4 • requirements that the new UNS Energy Board of Directors have a majority of  
5 the board members be independent and that a majority will reside in Arizona;
- 6 • financial transparency and reporting requirements; and
- 7 • corporate governance requirements to protect the Regulated Utilities from any  
8 potential adverse impacts of the acquisition.

9 The Settlement Conditions are discussed later in more detail.

10

11 Second, the Settlement Conditions incorporate applicable conditions from the 1997 TEP  
12 Holding Company Order, with the intent that the conditions approved in this Docket will  
13 replace the conditions in the 1997 TEP Holding Company Order.

14

15 Third, the signatories to the Settlement Agreement request that the Commission approve  
16 the Settlement Agreement no later than September 18, 2014 so that the transaction can  
17 close by September 30, 2014. This timing has the benefit of: (i) allowing the Purchased  
18 Power and Fuel Adjustment Clause ("PPFAC") credit to go into effect on October 1,  
19 2014 to partially offset the October 1, 2014 TEP PPFAC increase<sup>3</sup>; (ii) allowing the UNS  
20 Gas Purchased Gas Adjustor ("PGA") credit to go into effect on October 1, 2014 as bills  
21 begin to increase during the winter heating season; and (iii) reducing debt financing costs  
22 and related costs needed for the purchase of Gila River Unit 3 and SGS assets.

23

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<sup>3</sup> Decision No. 74439 (April 18, 2014).

1 **III. SETTLEMENT PROCESS.**

2  
3 **Q. Please provide an overview of the settlement process.**

4 A. Pursuant to the procedural orders issued in this Docket, formal settlement discussions  
5 were noticed and began on May 5, 2014, after Direct Testimony was filed by the  
6 Commission's Utility Division Staff ("Staff") and other intervening parties.

7  
8 All parties to the Docket were notified of the meetings and invited to participate either in  
9 person or telephonically.

10  
11 Thereafter, the final details of the Settlement Agreement, including the numerous  
12 conditions, were negotiated and incorporated into a definitive draft. All parties were  
13 given the opportunity to review and comment on the Settlement Agreement before it was  
14 finalized. They were also given the opportunity to become Signatories to the Settlement  
15 Agreement before it was filed on May 16, 2014.

16  
17 **Q. Do you believe that the settlement process was open and transparent?**

18 A. Yes, I do. All parties to the Docket were invited to participate and most of the parties  
19 attended the settlement discussions in person. As a result of the process, Staff, RUCO  
20 and eight other intervenors representing diverse interests became Signatories to the  
21 Settlement Agreement. I would like to take this opportunity to thank all of the parties for  
22 their participation in a very cooperative and constructive settlement process.

23  
24 **IV. SETTLEMENT PROVISIONS.**

25  
26 **Q. What are the three primary elements of the Settlement Agreement?**

27 A. The Settlement Agreement sets forth 66 conditions of approval. It also addresses how the

1 approval of the proposed acquisition will impact the 1997 TEP Holding Company Order.  
2 Finally, the Settlement Agreement requests Commission approval of the Settlement  
3 Agreement by September 18, 2014.

4  
5 **A. Settlement Conditions.**

6  
7 **Q. Please provide an overview of the conditions of approval set forth in the Settlement**  
8 **Agreement from UNS Energy's perspective.<sup>4</sup>**

9 A. The 66 Settlement Conditions represent a combination of the conditions proposed by  
10 Staff, RUCO and other intervenors in their Direct Testimonies as well as 24 conditions  
11 that the Joint Applicants proposed in the Joint Notice (to the extent they were not  
12 addressed by conditions proffered by other parties). Moreover, the Settlement Conditions  
13 include conditions from the 1997 TEP Holding Company Order.

14  
15 Attachment A to the Settlement Agreement sets forth the Settlement Conditions.  
16 Generally, the Settlement Conditions address: customer benefits and protections; credit  
17 quality and capital requirements; quality of service; customer programs; corporate  
18 governance; financial transparency and reporting requirements; acknowledgment of  
19 Arizona laws and procedures; and other miscellaneous issues.

20  
21 **Q. Do you believe that the Settlement Conditions address the concerns raised by Staff,**  
22 **RUCO and other intervenors?**

23 A. I believe they address the vast majority of concerns raised in the Direct Testimony. The  
24 Settlement Conditions do not attempt to address issues that are generally considered to be  
25 policy issues within the Commission's purview, to revisit issues that the Commission has

26  
27 <sup>4</sup> The Direct Testimony of Barry V. Perry in support of the Settlement Agreement addresses the Settlement Conditions that specifically impact or place specific commitments on Fortis upon, and subsequent to, its acquisition of UNS Energy.

1 addressed in the past, or to address issues that are clearly outside the scope of this  
2 Docket.

3  
4 As noted in Section 2 of the Settlement Agreement, the Signatories agree that the merger  
5 transaction, subject to the 66 Settlement Conditions, is in the public interest and would  
6 not impair UNS Energy or the Regulated Utilities.

7  
8 **1. Customer Benefits and Protections.**

9 **Q. Please describe the conditions regarding customer benefits and protections.**

10 A. Conditions 1 through 15 contain provisions intended to provide customer benefits and  
11 protections. The two most notable customer benefit conditions are Condition 1, which  
12 provides for \$30 million of customer credits over the next five years, and Condition 2,  
13 which requires Fortis to infuse \$220 million of equity into the Regulated Utilities through  
14 UNS Energy within 60 days of the close of the transaction.

15  
16 There are also numerous conditions that are designed to protect the Regulated Utilities'  
17 customers from costs related to the merger. For example, transaction costs, acquisition  
18 premiums or other costs related to the merger will not be recovered through rates.

19  
20 **Q. How will the \$30 million in bill credits be passed on to the customers?**

21 A. A total of \$10 million will be credited to the Regulated Utilities' customer bills in Year  
22 One (starting on October 1, 2014) and a total of \$5 million will be credited each year in  
23 Years Two through Five. The allocation of the total credit amount among the Regulated  
24 Utilities will be based on number of customers. For example, in Year One, of the \$10  
25 million total, approximately \$6.3 million would go to TEP customers, \$1.4 million would  
26 go to UNS Electric customers and \$2.3 million would go to UNS Gas customers.



1 For Year One, the credits will be made through both a bill credit to the monthly customer  
2 charge (\$5 million) and PPFAC and PGA credits (\$5 million). The monthly bill credit  
3 will be calculated as an amount proportional to the average monthly customer charge in  
4 each class. The PPFAC/PGA credit will offset the PPFAC/PGA rate.

5  
6 For Years Two through Five, the \$5 million in annual credits will be applied to the  
7 monthly customer charge. There will not be a PPFAC or PGA credit applied in years  
8 Two through Five.

9  
10 Finally, as provided in Condition 1(c), the bill credit will be applied only for a six month  
11 period from October 1 through March 31 for each of the next five years.

12  
13 As a result of Condition 1, in the first six months of Year One, the combined monthly  
14 charge credit and the PPFAC/PGA credit will result in a winter bill reduction for the  
15 average residential customer of approximately 2% for TEP, approximately 2.5% for UNS  
16 Electric and approximately 4% for UNS Gas.

17  
18 The attached Exhibit DGH-3 provides (i) additional information on the allocation of the  
19 \$30 million among the Regulated Utilities, and (ii) the estimated bill impact of the credits  
20 for the average residential customers of each Regulated Utility.

21  
22 **Q. How will the \$220 million equity infusion benefit the Regulated Utilities and their**  
23 **customers?**

24 **A.** TEP and UNS Electric plan to make significant capital expenditures towards the end of  
25 this year, including the acquisition of Gila River Unit 3. The equity infusion will reduce  
26 the need for debt financing of those purchases, thereby reducing interest costs that will be  
27 passed on to customers through the ratemaking process. On a long-term basis, this

1 additional equity improves the financial strength of the Regulated Utilities.

2  
3 **2. Credit Quality and Capital Requirements.**

4 **Q. Please describe the conditions regarding credit quality and capital requirements.**

5 A. Conditions 16 through 25 address credit quality and capital requirements following the  
6 merger. Most notable is Condition 16, which will improve the capital structure of the  
7 Regulated Utilities through restrictions on dividends for the earlier of five years or until  
8 such time as the respective Regulated Utility's equity capitalization reaches 50 percent.

9  
10 Additionally, Conditions 17, 21 and 24 require UNS Energy to maintain a capital  
11 structure separate from Fortis, to maintain separate banking, credit facility and cash  
12 management arrangements and to continue to maintain separate credit ratings from Fortis.  
13 Moreover, other conditions restrict the ability of the Regulated Utilities from providing  
14 certain financial support to Fortis, including Condition 25, which prohibits cross-default  
15 provisions that could impact the Regulated Utilities.

16  
17 **3. Quality of Service.**

18 **Q. Please describe the conditions regarding quality of service.**

19 A. Conditions 26 through 30 provide requirements that are intended to ensure the Regulated  
20 Utilities' customers continue to receive at least the level of safe, reliable utility service  
21 that customers are currently receiving. For example, Condition 26 requires that senior  
22 management will be "on the ground" in Arizona to address customer service issues.  
23 Condition 27 provides that employee levels will be maintained for a period of at least  
24 four years – supporting the Regulated Utilities' efforts to maintain or improve customer  
25 service and service quality levels. Moreover, under Condition 29, the Regulated Utilities  
26 commit to continue their ongoing efforts to maintain and improve safe and reliable  
27 service.

1                   4.     **Customer Programs.**

2     **Q.     Please describe the conditions regarding customer programs.**

3     A.     Conditions 31 through 35 primarily address issues raised in the intervenors' testimonies  
4             and reflect the Joint Applicants' willingness to continue to work constructively with a  
5             variety of stakeholders. Under these conditions, the Regulated Utilities have committed  
6             to continue certain customer programs. For example, Condition 35 provides that the  
7             Regulated Utilities and Fortis commit to continue low-income assistance programs at or  
8             above current levels.

9  
10                  5.     **Corporate Governance.**

11    **Q.     Please describe the conditions regarding corporate governance?**

12    A.     Conditions 36 through 42 reflect provisions intended to protect the Regulated Utilities  
13             and their customers from financial weakness that may be suffered by Fortis in the future.  
14             These "ring fencing" conditions require that a majority of the members of the UNS  
15             Energy board of directors be Arizona residents and that a majority be independent.  
16             Additionally, a "golden share" mechanism will be established. These conditions ensure  
17             that Arizona interests continue to be represented in the corporate governance process.

18  
19             These conditions also require that the corporate headquarters remain in Tucson and  
20             provide that local management continue to make decisions about the Regulated Utilities'  
21             operations.

22  
23                  6.     **Financial Transparency and Reporting Requirements.**

24    **Q.     Please describe the conditions regarding financial transparency reporting**  
25             **requirements?**

26    A.     Conditions 43 through 51 provide a means by which the Commission has necessary  
27             access and information to oversee the reorganized corporate entities. For example,

1 Condition 43 sets forth an annual reporting requirement that tracks compliance with the  
2 Settlement Conditions. Condition 46 requires UNS Energy to keep accounting books and  
3 records separate from Fortis and to continue to make those records available to the  
4 Commission. Condition 47 requires Fortis to provide access to its records regarding any  
5 transaction that may have some direct or indirect impact on the Regulated Utilities.  
6

7 **7. Other Conditions.**

8 **Q. Please describe the conditions regarding other issues.**

9 A. Conditions 52 through 66 address a variety of topics. These conditions describe various  
10 Arizona laws and procedures applicable to Fortis, UNS Energy and the Regulated  
11 Utilities. For example, under Condition 54, UNS Energy and the Regulated Utilities will  
12 not share customer-specific information with Fortis affiliates except under certain  
13 circumstances and parameters.  
14

15 These conditions also contain several conditions from the 1997 TEP Holding Company  
16 Order and other conditions related to relations between affiliated companies. For  
17 example, Condition 58 requires that the Regulated Utilities develop and submit for  
18 Commission approval proposed procedures for valuing and allocating intercompany  
19 transactions to and between the Regulated Utilities and other affiliates, including the  
20 transfers of goods and services among them.  
21

22 **B. 1997 TEP Holding Company Order.**

23  
24 **Q. Why does the Settlement Agreement address the existing 1997 TEP Holding  
25 Company Order?**

26 A. The 1997 TEP Holding Company Order approved the creation of UniSource Energy  
27 Corporation (since renamed UNS Energy) as a holding company for TEP. It contains a

1 variety of conditions that were relevant 17 years ago given the circumstances that existed  
2 at the time. Since then, significant changes at UNS Energy and the evolving utility  
3 landscape have rendered certain conditions meaningless, ineffective or inappropriate.  
4 The Commission has modified some of those conditions in the past to reflect such  
5 changes. See Decision No. 71256 (September 3, 2009); Decision No. 62103 (November  
6 30, 1999). There have been additional changes to circumstances since 2009, and the  
7 acquisition will further affect the appropriateness and applicability of those old  
8 conditions.

9  
10 In light of these changing circumstances and modifications, it is difficult to know which  
11 conditions of the 1997 TEP Holding Company Order are in effect and which are not.  
12 Once the proposed Fortis-UNS Energy merger is approved, the Commission is effectively  
13 creating a new holding company. Going forward, it would be even more challenging to  
14 interpret the 1997 TEP Holding Company Order in conjunction with the order in this  
15 Docket. Therefore, it makes sense to update the still-relevant conditions from the 1997  
16 TEP Holding Company Order and incorporate them in the order in this Docket and then  
17 vacate the conditions of the 1997 TEP Holding Company Order. As a result of this  
18 approach, all conditions related to this new holding company structure will be located in  
19 one order.

20  
21 **Q. Does the Settlement Agreement include appropriate “hold over” conditions from the**  
22 **1997 TEP Holding Company Order?**

23 **A.** Yes. As part of the settlement process, the Signatories carefully reviewed the 1997 TEP  
24 Holding Company Order conditions and agreed upon which conditions should continue  
25 in force. Those conditions are included in the 66 Settlement Conditions. Section 3 of the  
26 Settlement Agreement further provides that the conditions adopted in this Docket shall  
27 supersede the conditions of the 1997 TEP Holding Company Order and that such

1 superseded conditions be vacated.

2  
3 **C. Timing of the Approval of the Acquisition.**

4  
5 **Q. The Settlement Agreement includes a provision concerning approval by September**  
6 **18, 2014. Could you explain why that provision is important?**

7 **A.** In Section 1.9 of the Settlement Agreement, the Signatories request that the Commission  
8 approve the Settlement Agreement no later than September 18, 2014. This will allow the  
9 transaction to close by September 30, 2014. Closing the transaction by September 30 has  
10 several benefits. First, the PPFAC credit provided by Condition 1 can go into effect on  
11 October 1, 2014 to partially offset the October 1, 2014 TEP PPFAC increase<sup>5</sup>. Similarly  
12 the PGA credit for UNS Gas customers can go into effect as bills begin to rise during the  
13 winter home heating season.

14  
15 Second, as a result of the acquisition, Fortis will immediately infuse \$220 million of  
16 equity into the Regulated Utilities through UNS Energy. This equity infusion will reduce  
17 the amount and cost of debt financing required for the purchase of Gila River Unit 3 and  
18 the SGS assets later this year and early next year. Again, this, coupled with the  
19 anticipated credit rating upgrade, will result in lower interest costs and an improved  
20 financial profile for the Regulated Utilities.

21  
22 **V. RULE 803(C) FACTORS AND THE PUBLIC INTEREST.**

23  
24 **Q. Do you believe the acquisition, subject to the Settlement Conditions, should be**  
25 **approved by the Commission under the standard set forth in Arizona**  
26 **Administrative Code R14-2-803(C)?**

27  

---

<sup>5</sup> Decision No. 74439.

1 A. Yes, I do. A.A.C. R14-2-803(C) states that "At the conclusion of any hearing on the  
2 organization or reorganization of a utility holding company, the Commission may reject  
3 the proposal if it determines that it would impair the financial status of the public utility,  
4 otherwise prevent it from attracting capital at fair and reasonable terms, or impair the  
5 ability of the public utility to provide safe, reasonable and adequate service." The  
6 acquisition will not impair the financial status of any of the Regulated Utilities, nor will it  
7 prevent them from attracting capital at fair and reasonable terms. To the contrary,  
8 affiliation with the financial strength of Fortis should **improve** the financial status of the  
9 Regulated Utilities and their access to debt and equity capital on more favorable terms.

10  
11 The acquisition also will not impair the ability of any of the Regulated Utilities to provide  
12 safe, reasonable and adequate service. The Regulated Utilities will continue to provide  
13 safe, reliable service to customers under their existing local management team in  
14 accordance with the standalone operating philosophy of Fortis while also having access  
15 to the best practices of Fortis' well-run utilities. The increased access to the capital  
16 markets will help the Regulated Utilities make the investments needed to maintain a high  
17 quality of service to their customers. Moreover, Fortis, UNS Energy and the Regulated  
18 Utilities have committed to continuing their steady efforts to maintain and improve the  
19 current quality of utility service.

20  
21 **Q. Do you believe that Commission approval of the acquisition subject to the**  
22 **Settlement Conditions is in the public interest?**

23 A. Yes. The financial benefits of the acquisition, coupled with the extensive commitments  
24 embodied in the Settlement Conditions, will provide tangible benefits to the customers of  
25 the Regulated Utilities and communities they serve. Moreover, Fortis has a solid track  
26 record with the ownership of well-run, locally managed utilities

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**VI. CONCLUSION.**

**Q. Do you have any concluding remarks?**

A. Yes. The acquisition is beneficial to the Regulated Utilities, their customers and the communities they serve. I believe that Commission approval of this acquisition is in the public interest.

**Q. Does this conclude your testimony?**

A. Yes.



## **Exhibit DGH - 3**

## Exhibit DGH-3

### Settlement Agreement Ratepayer Credits \$10 million in Year 1; \$5 million per year in Years 2-5

#### Allocation of \$30 million among Regulated Utilities

##### Allocation of \$10 million for Year 1

<u>Utility</u>	<u>Customers</u>	<u>Percentage</u>	<u>Allocation</u>
TEP	409,528	62.90%	\$6,290,000
UNSE	92,550	14.22%	\$1,422,000
UNSG	148,955	22.88%	\$2,288,000

##### Allocation of \$5 million for Years 2-5

<u>Utility</u>	<u>Customers</u>	<u>Percentage</u>	<u>Allocation</u>
TEP	409,528	62.90%	\$3,145,000
UNSE	92,550	14.22%	\$711,000
UNSG	148,955	22.88%	\$1,144,000

#### Average Residential Bill Impact<sup>1</sup>

<b>Year 1</b>	<b>TEP</b>	<b>UNSE</b>	<b>UNSG</b>
Monthly Charge Credit	\$1.07	\$1.15	\$1.19
PPFAC/PGA Credit <sup>2</sup>	<u>\$0.56</u>	<u>\$0.69</u>	<u>\$1.66</u>
Total Credit	\$1.63	\$1.84	\$2.85
 <b>Years 2-5</b>	 <b>TEP</b>	 <b>UNSE</b>	 <b>UNSG</b>
Monthly Charge Credit	\$1.07	\$1.15	\$1.19

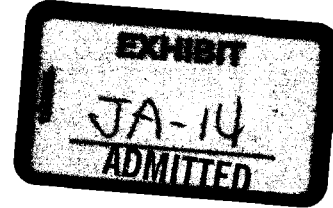
<sup>1</sup> Credits will only be applied during six-month period (October 1 through March 31) for each year.

<sup>2</sup> PPFAC/PGA credits based on average monthly usage October 1-March 31: TEP & UNSE - 700 kWh; UNSG - 64 therms.

1                                   **BEFORE THE ARIZONA CORPORATION COMMISSION**

2   **COMMISSIONERS**

3   BOB STUMP, CHAIRMAN  
4   GARY PIERCE  
5   BRENDA BURNS  
6   BOB BURNS  
7   SUSAN BITTER SMITH




8   IN THE MATTER OF THE REORGANIZATION ) DOCKET NO. E-04230A-14-0011  
9   OF UNS ENERGY CORPORATION ) DOCKET NO. E-01933A-14-0011  
10    )  
11    ) NOTICE OF FILING - LENDER  
12    ) CONSENT  
13    )  
14    )  
15    )

16                   UNS Energy Corporation<sup>1</sup> and Fortis Inc.<sup>2</sup> hereby submit notice that, pursuant to Condition  
17   16 of the May 16, 2014 Settlement Agreement, the lenders in the UNS Energy credit facility have  
18   consented to the dividend restrictions set forth in Condition 16. A copy of the 8-K filing regarding  
19   that consent is attached.

20                                   RESPECTFULLY SUBMITTED this 11<sup>th</sup> day of June, 2014

21                                   UNS ENERGY CORPORATION

22                   By   
23                   Bradley S. Carroll  
24                   UNS Energy Corporation  
25                   88 East Broadway Blvd., MS HQE910  
26                   P. O. Box 711  
                    Tucson, Arizona 85702

                                    and

<sup>1</sup> On behalf of itself and its affiliates UniSource Energy Services, Inc., Tucson Electric Power Company, UNS Electric, Inc. and UNS Gas, Inc.

<sup>2</sup> On behalf of itself and its affiliates FortisUS Holdings Nova Scotia Limited, FortisUS Inc. and Color Acquisition Sub Inc.

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13 Attorneys for Fortis Inc.

14 Original and 13 copies of the foregoing  
15 filed this 11<sup>th</sup> day of June, 2014 with:

16 Docket Control  
17 Arizona Corporation Commission  
18 1200 West Washington Street  
19 Phoenix, Arizona 85007

20 Copy of the foregoing hand-delivered/emailed  
21 this 11<sup>th</sup> day of June, 2014 to:

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23 Administrative Law Judge  
24 Hearing Division  
25 Arizona Corporation Commission  
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27 Tucson, Arizona 85701

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 8-K  
CURRENT REPORT**

Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

Date of Report (date of earliest event reported): June 9, 2014

Commission File Number	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification Number
<b>1-13739</b>	<b>UNS ENERGY CORPORATION</b> (An Arizona Corporation) 88 E. Broadway Boulevard Tucson, AZ 85701 (520) 571-4000	<b>86-0786732</b>
<b>1-5924</b>	<b>TUCSON ELECTRIC POWER COMPANY</b> (An Arizona Corporation) 88 E. Broadway Boulevard Tucson, AZ 85701 (520) 571-4000	<b>86-0062700</b>

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- ☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- ☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- ☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- ☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))



### **Item 8.01 Other Events.**

As previously reported, on January 10, 2014, UNS Energy and Fortis Inc. (Fortis) filed an application with the Arizona Corporation Commission (ACC) requesting that the ACC approve a proposed merger (Merger) in which UNS Energy would become an indirect wholly-owned subsidiary of Fortis.

On May 16, 2014, UNS Energy, Fortis, ACC Staff, the Residential Utility Consumer Office and other parties to the Merger proceedings entered into a settlement (Settlement) in which the parties agree that the Merger is in the public interest and recommend approval by the ACC, subject to certain conditions, including a condition that dividends paid from Tucson Electric Power Company, UNS Electric, Inc. and UNS Gas, Inc. (collectively, the Regulated Utilities) to UNS Energy cannot exceed 60 percent of the Regulated Utilities' respective net income for a period of five years or until such time that their respective equity capitalization reaches 50 percent of total capital (excluding any goodwill recorded) as accounted for in accordance with U.S. Generally Accepted Accounting Principles.

The dividend restrictions were contingent upon receiving necessary consents of the lenders in UNS Energy's credit facility, which consents were obtained as of June 9, 2014.

Completion of the Merger remains subject to: the approval of the ACC; the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended; and the satisfaction of other customary closing conditions.

UNS Energy expects the Merger to close by the end of 2014.

## **SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: June 11, 2014

**UNS ENERGY CORPORATION**

---

(Registrant)

/s/ Kevin P. Larson

Kevin P. Larson  
Senior Vice President and Chief Financial Officer

Date: June 11, 2014

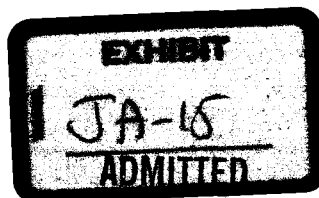
**TUCSON ELECTRIC POWER COMPANY**

---

(Registrant)

/s/ Kevin P. Larson

Kevin P. Larson  
Senior Vice President and Chief Financial Officer



BEFORE THE ARIZONA CORPORATION COMMISSION

**COMMISSIONERS**  
BOB STUMP, CHAIRMAN  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH

Arizona Corporation Commission

**DOCKETED**

JUN 13 2014

DOCKETED BY

ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

2014 JUN 13 P 3

RECEIVED

IN THE MATTER OF THE REORGANIZATION  
OF UNS ENERGY CORPORATION

) DOCKET NO. E-04230A-14-0011  
) DOCKET NO. E-01933A-14-0011

**ORIGINAL**

) NOTICE OF FILING  
) SUPPLEMENTAL INFORMATION  
) IN SUPPORT OF APPLICATION -  
) HART-SCOTT-RODINO ACT

UNS Energy Corporation<sup>1</sup> and Fortis Inc.<sup>2</sup> hereby submit notice that the United States Federal Trade Commission ("FTC") granted UNS Energy's request for early termination of the waiting period with respect to the proposed acquisition by Fortis under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. A copy of the UNS Energy 8-K filing regarding the FTC's action is attached.

RESPECTFULLY SUBMITTED this 13th day of June, 2014

UNS ENERGY CORPORATION

By

Bradley S. Carroll  
UNS Energy Corporation  
88 East Broadway Blvd., MS HQE910  
P. O. Box 711  
Tucson, Arizona 85702

and

<sup>1</sup> On behalf of itself and its affiliates UniSource Energy Services, Inc., Tucson Electric Power Company, UNS Electric, Inc. and UNS Gas, Inc.

<sup>2</sup> On behalf of itself and its affiliates FortisUS Holdings Nova Scotia Limited, FortisUS Inc. and Color Acquisition Sub Inc.

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Michael W. Patten  
Roshka DeWulf & Patten, PLC  
One Arizona Center  
400 East Van Buren Street, Suite 800  
Phoenix, Arizona 85004  
  
Attorneys for UNS Energy Corporation  
  
and  
  
Patricia Lee Refo  
Snell & Wilmer, L.L.P.  
One Arizona Center  
400 East Van Buren Street, Suite 1900  
Phoenix, Arizona 85004  
  
Attorneys for Fortis Inc.

Original and 13 copies of the foregoing  
filed this 13th day of June, 2014 with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Copy of the foregoing hand-delivered/emailed  
this 13th day of June, 2014 to:

Jane L. Rodda  
Administrative Law Judge  
Hearing Division  
Arizona Corporation Commission  
400 West Congress  
Tucson, Arizona 85701

Brian E. Smith  
Bridget A. Humphrey  
Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

- 1 Steve Olea
- 2 Director, Utilities Division
- 3 Arizona Corporation Commission
- 4 1200 West Washington Street
- 5 Phoenix, Arizona 85007
- 6 Daniel W. Pozefsky
- 7 Chief Counsel
- 8 Residential Utility Consumer Office
- 9 1110 West Washington, Suite 220
- 10 Phoenix, Arizona 85007
- 11 C. Webb Crockett
- 12 Patrick Black
- 13 Fennemore Craig PC
- 14 2394 E. Camelback Road, Suite 600
- 15 Phoenix, Arizona 85016
- 16 Meghan H. Grabel
- 17 Arizona Public Service Company
- 18 P.O. Box 53999, MS 9708
- 19 Phoenix, AZ 85072-3999
- 20 Thomas L. Mumaw
- 21 Melissa Krueger
- 22 Pinnacle West Capital Corporation
- 23 P.O. Box 53999, MS 8695
- 24 Phoenix, AZ 85072-3393
- 25 Cynthia Zwick
- 26 Arizona Community Action Association
- 27 2700 N. 3<sup>rd</sup> Street, Suite 3040
- 28 Phoenix, AZ 85004
- 29 Nicholas J. Enoch
- 30 Jarrett J. Haskovec
- 31 Lubin & Enoch, PC
- 32 349 North Fourth Avenue
- 33 Phoenix, AZ 85003
- 34 Lawrence V. Robertson
- 35 P.O. Box 1448
- 36 Tubac, AZ 85646
- 37 Timothy M. Hogan
- 38 Arizona Center for Law in Public Interest
- 39 202 E. McDowell Road, Suite 153
- 40 Phoenix, AZ 85004

- 1 Jeff Schlegel  
SWEEP Arizona Representative  
1167 W. Samalayuca Drive
- 2 Tucson, AZ 85704-3224
- 3 Michael M. Grant  
Jennifer A. Cranston
- 4 Gallagher & Kennedy, PA  
2575 East Camelback Road, 11<sup>th</sup> Floor
- 5 Phoenix, AZ 85016-9225
- 6 Gary Yaquinto  
Arizona Investment Council
- 7 2100 North Central Avenue, Suite 210  
Phoenix, AZ 85004
- 8 Michael A. Curtis  
William P. Sullivan
- 9 Larry K. Udall  
Curtis, Goodwin, Sullivan, Udall & Schwabb, PLC
- 10 501 East Thomas Road  
Phoenix, AZ 85012
- 11 Peggy Gillman  
Mohave Electric Cooperative, Inc.
- 12 P.O. Box 1045  
Bullhead City, AZ 86430
- 14 Joe L. Machado  
Michael J. Massee
- 15 City Attorney's Office  
777 N. Grand Avenue
- 16 Nogales, AZ 85621
- 17 Court S. Rich  
Rose Law Group, PC
- 18 7144 E. Stetson Drive, Suite 300  
Scottsdale, AZ 85251
- 19 Christopher Hitchcock  
Law Offices of Christopher Hitchcock
- 20 P.O. Box AT  
Bisbee, AZ 85603-0115
- 22 Jack Blair  
Sulphur Springs Valley Electric Cooperative, Inc.
- 23 311 E. Wilcox Drive  
Sierra Vista, AZ 85635-2527
- 24 Charles R. Moore  
Navopache Electric Cooperative
- 25 1878 West White Mountain Blvd.  
Lakeside, AZ 85929
- 26
- 27

1 Garry D. Hays  
Law Offices of Garry D. Hays  
1702 East Highland Avenue, Suite 204  
2 Phoenix, AZ 85016

3 Giancarlo G. Estrada  
Estrada-Legal, PC  
4 One East Camelback Road, Suite 550  
Phoenix, AZ 85012  
5

6 By Jaclyn Howard  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 8-K  
CURRENT REPORT**

Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

Date of Report (date of earliest event reported): June 13, 2014

Commission File Number	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification Number
1-13739	<b>UNS ENERGY CORPORATION</b> (An Arizona Corporation) 88 E. Broadway Boulevard Tucson, AZ 85701 (520) 571-4000	86-0786732
1-5924	<b>TUCSON ELECTRIC POWER COMPANY</b> (An Arizona Corporation) 88 E. Broadway Boulevard Tucson, AZ 85701 (520) 571-4000	86-0062700

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- ☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- ☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- ☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- ☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))



**Item 8.01 Other Events.**

As previously reported, on December 11, 2013, UNS Energy Corporation (UNS Energy) entered into an Agreement and Plan of Merger pursuant to which a subsidiary of Fortis Inc. (Fortis) would merge into UNS Energy (Merger) and UNS Energy would become an indirect wholly-owned subsidiary of Fortis.

On June 13, 2014, the United States Federal Trade Commission granted UNS Energy's request for early termination of the waiting period with respect to the proposed acquisition by Fortis under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

The Merger was approved by UNS Energy shareholders on March 26, 2014 and by the Federal Energy Regulatory Commission on April 2, 2014. On May 20, 2014, the United States Department of the Treasury informed UNS Energy that the Committee on Foreign Investment in the United States completed its review of the Merger.

Completion of the Merger remains subject to the approval of the Arizona Corporation Commission and the satisfaction of other customary closing conditions.

UNS Energy expects the Merger to close by the end of 2014.

## **SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: June 13, 2014

### **UNS ENERGY CORPORATION**

\_\_\_\_\_  
(Registrant)

/s/ Kevin P. Larson

Kevin P. Larson  
Senior Vice President and Chief Financial Officer

Date: June 13, 2014

### **TUCSON ELECTRIC POWER COMPANY**

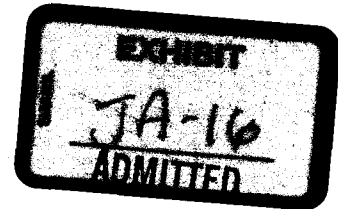
\_\_\_\_\_  
(Registrant)

/s/ Kevin P. Larson

Kevin P. Larson  
Senior Vice President and Chief Financial Officer



P.O. Box 711  
Tucson, Arizona 85702



January 31, 2013

Steven Olea, Director  
Arizona Corporation Commission  
Utilities Division  
1200 West Washington Street  
Phoenix, AZ 85007

Re: UES to Cease Taking Payments at its Nogales Office

Dear Mr. Olea:

Since acquiring Citizen's Utilities' Arizona electric and gas operations, UniSource Energy Services ("UES" or "Company") has taken numerous steps to standardize, economize and improve customer services. This has included a combined payment remittance program and consolidated call center services with Tucson Electric Power ("TEP"). As a result, UES was able to provide extended operating hours, bilingual customer service representatives, and offer an extended variety of bill payment methods, including the ability to pay a UES bill at Wal-Mart Stores nationwide.

In 2008, UES stopped accepting customer bill payments at all of its offices, with the exception of Nogales, Arizona. On March 29, 2013, UES will also stop accepting customer bill payments at our Nogales office. Customers will continue to have the following options of paying their bill: Auto Pay; UES e-bill paperless billing; credit card, debit card or bank account withdrawal through the Company's website or telephone; or with cash (for a minimal fee) at Food City, K-Mart or any Wal-Mart store.

Over the last few months, UES employees at the Nogales office have been informing customers that payments will no longer be accepted at the office. We have also notified local government officials of the impending change and they are supportive of our actions. Customers will receive notice of the closure, as well as other payment options, through bill inserts, which will be included over the course of two billing cycles. We will also be hanging posters at the Nogales office notifying customers of the impending change. During the month of April, we will have a UES

employee available outside the former payment lobby to answer customers' questions.

When UES stopped accepting bill payments at its other offices in 2008, the Company installed an intercom system, a phone link to our call center and a dedicated computer kiosk in each office; however, very few customers have used these devices. As a result, we will not be installing them in the Nogales office.

These types of changes were discussed extensively in the 2008 UNS Gas rate case (Decision No. 71623, April 14, 2010). In that decision, UNS Gas was ordered to file a statement regarding the payment options at the Nogales office, the current status of the phone links and computer kiosks in all offices, and any other relevant information related to customer options for bill payments. UES filed a compliance report with the Commission addressing the above topics on May 12, 2010.

Additionally, Decision No. 71623 stated in the discussion section at page 65, that "if, prior to UNS Gas' next rate case, any substantive changes are made to the Company's bill payment options or availability of customer contacts at local offices, UNS Gas shall file in this docket, a statement regarding those changes." UNS Gas has not had any updates to file since that initial submission. Moreover, UNS Gas completed a subsequent rate case (Decision No. 73142, May 1, 2012). Accordingly no further compliance filings were required. However, in the event the Commission receives customer inquiries regarding the change in Nogales, we wanted to notify you in advance and inform you of the actions UES is taking to mitigate the impact on its customers.

UES is committed to providing safe, reliable service while at the same time ensuring the safety of our customers and employees. We anticipate a smooth transition when the Nogales office ceases to accept in-person bill payments.

If you have any questions, please do not hesitate to contact me.

Sincerely,



Jo Smith  
Director of Regulatory Services

cc: Chairman Bob Stump  
ACC Consumer Services Division – Connie Walczac

# A partir del 29 de marzo este vestíbulo y la ventanilla de servicio no procesarán más pagos

Muchas otras de las transacciones y preguntas de los clientes pueden ser procesadas en nuestra página de internet [uesaz.com](http://uesaz.com) o llamando sin costo al 877-UES-4YOU (877-837-4968). Nuestro Centro de Atención al Cliente está abierto para servirle de lunes a viernes de 7 a.m. a 6 p.m.

## Opciones de pago de UES

### Pago Automático

Disfrute de la comodidad de pagar sus cuentas automáticamente cada mes directamente de su cuenta de cheques o de ahorros. Es fácil, es seguro y es GRATIS. Visite [uesaz.com](http://uesaz.com), primero inscríbese en Account Manager y después en Auto Pay.

### Factura electrónica de UES

Factura electrónica es la manera más rápida, simple, cómoda, segura y garantizada para recibir y ver su factura de UES en internet a cualquier hora del día y en cualquier lugar. Regístrese para el programa de factura electrónica el cual le permitirá pagar completamente GRATIS usando una cuenta de cheques o de ahorros de Estados Unidos. Visite [uesaz.com](http://uesaz.com), inscríbese en Account Manager, y regístrese hoy mismo!

### Tarjeta de crédito, tarjeta de débito o retiro bancario automático

**Web** – Visite [uesaz.com](http://uesaz.com) y pague su cuenta en internet usando su tarjeta de crédito, su tarjeta de débito o por medio de retiro automático de su cuenta bancaria.\*

**Teléfono** – Use su tarjeta de crédito, su tarjeta de débito o realice un retiro automático de su cuenta de banco para pagar su cuenta de UES a través de nuestra línea gratuita para pagos.\*

Para pagar su cuenta de gas, llame al 1-800-284-9730.

Para pagar su cuenta de electricidad, llame al 1-800-285-4960.

\* La compañía que procesará su pago le cobrará una cuota de servicio.

### Correo postal de los Estados Unidos

Tal vez no sea de alta tecnología pero si utiliza el correo postal para enviar su pago por cheque o giro postal, éste llegará. Nosotros proveeremos el sobre y usted pone la estampilla postal.

### Lugares para hacer pagos en efectivo\*\*

**Walmart** (también se aceptan tarjetas de debito)  
100 W. White Park Dr.  
(520) 281-4974

**Food City**  
450 N. Grand Court Plaza  
(520) 287-4675

**K-Mart**  
300 W. Mariposa Rd.  
(520) 761-4844

\*\*Estos comerciantes cobran una cuota mínima por este servicio.

**UniSourceEnergy**  
**SERVICES**

**A partir del 29 de marzo el  
vestibulo y la ventanilla de  
servicio al cliente de UES en  
Nogales no procesará más pagos.**

## Opciones de pago de UES

Marzo 2013

Domingo	Lunes	Martes	Miércoles	Jueves	Viernes	Sábado
					1	2
3	4	5	6	7	8	9
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**No se preocupe, usted tendrá a su  
disposición varias maneras de obtener  
lo que necesita de UES**

Nosotros ya no procesaremos pagos en la oficina de UES en Nogales debido a las siguientes razones:

- Más y más clientes están descubriendo la facilidad y comodidad de pagar sus cuentas usando UES E-bill, el teléfono y otros métodos electrónicos.
- Los clientes que pagan en efectivo o con tarjeta de débito ahora podrán hacerlo en cualquier establecimiento de las tiendas Walmart.
- En UES constantemente buscamos maneras de aumentar la productividad y la eficiencia.

Muchas otras de las transacciones y preguntas de los clientes pueden ser procesadas en nuestra página de internet **uesaz.com** o llamando sin costo al **877-UES-4YOU** (877-837-4968).

Nuestro Centro de Atención al Cliente está abierto para servirle de lunes a viernes de 7 a.m. a 6 p.m.

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### Correo postal de los Estados Unidos

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**K-Mart**

300 W. Mariposa Rd. (520) 761-4844

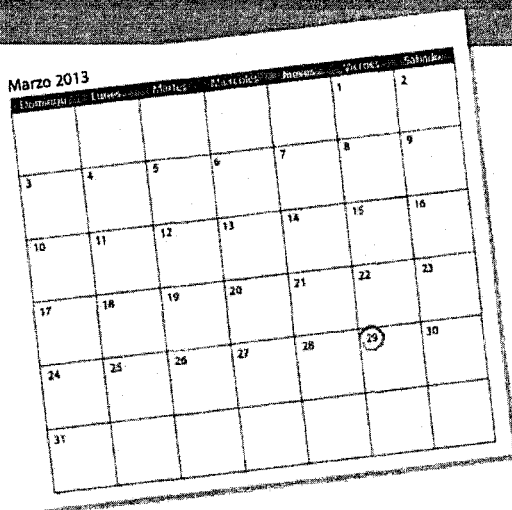
\*\*Estos comerciantes cobran una cuota mínima por este servicio.

**UniSourceEnergy**  
**SERVICES**

**uesaz.com**

877-UES-4YOU (877-837-4968)

**A partir del 29 de marzo  
este vestíbulo y la  
ventanilla de servicio no  
procesarán más pagos**



**TOME UNA**

**Usted todavía tendrá  
muchas maneras  
de conseguir lo que  
necesita de UES.**

Lista de opciones de  
pago disponibles

Para cualquier otras transacciones o preguntas:  
Visite **uesaz.com** o llame gratis al **877-UES-4YOU** (877-837-4968).

**UniSourceEnergy**  
**SERVICES**



# This lobby and drive-thru will no longer process payments beginning March 29

Many other customer transactions and inquiries can be handled online  
at [uesaz.com](http://uesaz.com) or by calling UES toll-free at 877-UES-4YOU  
(877-837-4968). Our Customer Care Center is open  
Monday through Friday, 7 a.m. to 6 p.m. to serve you.

## UES Payment Options

### Auto Pay

Enjoy the convenience of automatically paying your bill each month from your U.S. checking or savings account. It's easy. It's safe. It's FREE. Visit [uesaz.com](http://uesaz.com), enroll in Account Manager, and sign up for Auto Pay.

### UES E-bill Paperless Billing

E-bill paperless billing is the online, fast, simple, convenient, secure, guaranteed, anywhere, anytime way to receive and view your UES bill. Signing up for e-bill paperless billing also allows you the option to pay – for FREE – from a U.S. checking or savings account. Visit [uesaz.com](http://uesaz.com), enroll in Account Manager, and sign up today!

### Credit Card, Debit Card or Bank Account Withdrawal

**Web** – Visit [uesaz.com](http://uesaz.com) to pay your bill online using your credit card, debit card or bank account withdrawal.\*

**Telephone** – Use your credit card, debit card or bank account withdrawal to pay your UES bill via our toll-free payment hotline.\*

To pay your gas bill, call 1-800-284-9730.

To pay your electric bill, call 1-800-285-4960.

\*The third-party payment processor charges a convenience fee for this service.

### US Mail

It may not be high-tech, but it gets the job done for your check or money order payment. We supply the envelope, you supply the stamp.

### Cash Payment Locations\*\*

**Walmart** (also accepts debit cards)  
100 W. White Park Dr.  
(520) 281-4974

**Food City**  
450 N. Grand Court Plaza  
(520) 287-4675

**K-Mart**  
300 W. Mariposa Rd.  
(520) 761-4844

\*\*These retailers charge a nominal fee for this service.

The logo for UniSource Energy Services features the company name in a bold, sans-serif font. A curved line arches over the word "UniSource". Below "UniSource" is the word "Energy", and below "Energy" is the word "SERVICES" in all caps.



## UES Payment Options

**The UES lobby and drive-thru in Nogales will no longer process payments beginning March 29.**

### Auto Pay

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\*\*These retailers charge a nominal fee for this service.

**UniSourceEnergy**  
**SERVICES**

[uesaz.com](http://uesaz.com)

877-UES-4YOU (877-837-4968)

UES-Lobby Closure 1/13

March 2013

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
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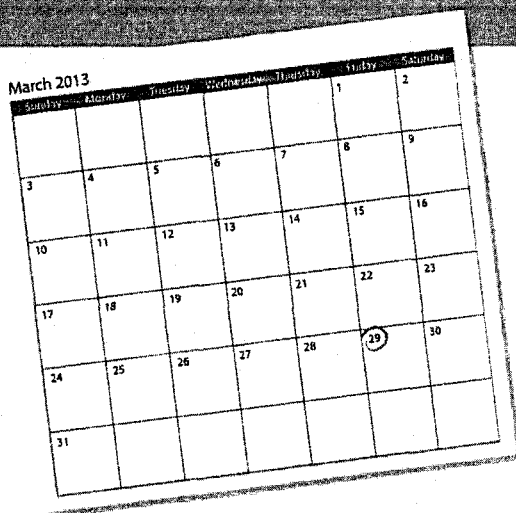
**You'll still have plenty of ways to get what you need from UES.**

We will no longer be processing payments at the UES office in Nogales because of several factors:

- More and more customers are discovering the convenience of UES E-bill paperless billing, telephone and other electronic payment methods.
- Cash and debit card paying customers may now visit any Walmart location and make a payment.
- UES is constantly looking for ways to increase productivity and efficiency.

Many other customer transactions and inquiries can be handled online at [uesaz.com](http://uesaz.com) or by calling UES toll-free at **877-UES-4YOU** (877-837-4968). Our Customer Care Center is open Monday through Friday, 7 a.m. to 6 p.m. to serve you.

# This lobby and drive-thru will no longer process payments beginning March 29



TAKE ONE

**You'll still have  
plenty of ways to  
get what you need  
from UES.**

List of available  
payment options

Other customer transactions and inquiries:  
Visit [uesaz.com](http://uesaz.com) or call toll-free **877-UES-4YOU** (877-837-4968).

**UniSourceEnergy**  
SERVICES

Bill Message Copy

Beginning March 29, the Nogales lobby and drive-thru will no longer process payments. Visit [uesaz.com](http://uesaz.com) or call toll-free 877-837-4968 for more information and a list of available payment options.

ORIGINAL

EXHIBIT

5-1  
ADMITTED

BEFORE THE ARIZONA CORPORATION

RECEIVED

2014 APR 30 P 4 15

AZ CORP COMMISSION  
DOCKET CONTROL

**COMMISSIONERS**

BOB STUMP - Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH

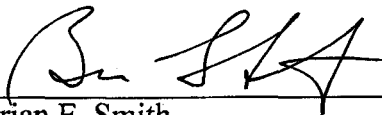
IN THE MATTER OF THE REORGANIZATION  
OF UNS ENERGY CORPORATION.

DOCKET NO. E-04230A-14-0011  
E-01933A-14-0011

**STAFF'S NOTICE OF FILING DIRECT  
TESTIMONY**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Direct Testimony of  
Gerald Becker in the above docket.

RESPECTFULLY SUBMITTED this 30<sup>th</sup> day of April, 2014.

  
\_\_\_\_\_  
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Bridget Humphrey  
Attorneys, Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Original and thirteen (13) copies  
of the foregoing filed this  
30<sup>th</sup> day of April 2014 with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Copy of the foregoing emailed and/or  
mailed this 30<sup>th</sup> day of April 2014 to:

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Arizona Corporation Commission  
**DOCKETED**

APR 30 2014

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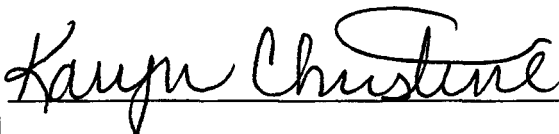
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28

**BEFORE THE ARIZONA CORPORATION COMMISSION**

**BOB STUMP**

Chairman

**GARY PIERCE**

Commissioner

**BRENDA BURNS**

Commissioner

**BOB BURNS**

Commissioner

**SUSAN BITTER SMITH**

Commissioner

IN THE MATTER OF THE APPLICATION )  
FOR APPROVAL OF THE REORGANIZATION)  
OF UNS ENERGY CORPORATION ON )  
BEHALF OF ITSELF AND ITS AFFILIATES )  
UNISOURCE ENERGY SERVICES AND )  
TUCSON ELECTRIC POWER COMPANY )

DOCKET NOS. E-01933A-14-0011

E-04230A-14-0011

DIRECT

TESTIMONY

OF

GERALD BECKER

EXECUTIVE CONSULTANT

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

APRIL 30, 2014

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**EXECUTIVE SUMMARY**  
**UNS ENERGY CORPORATION**  
**DOCKET NOS. E-04230A-14-0011 AND E-01933A-14-0011**

On January 24, 2014, UNS Energy Corporation ("UNS Energy"), on behalf of itself and its affiliates UniSource Energy Services, Inc., Tucson Electric Power Company, UNS Electric, Inc. and UNS Gas, Inc., and Fortis Inc. ("Fortis") on behalf of itself and its affiliates, FortisUS Holdings Nova Scotia Limited, FortisUS Inc., and Color Acquisition Sub Inc. filed an application to reorganize UNS Energy whereby Fortis would acquire UNS Energy for US\$60.25 per common share in cash, representing an aggregate purchase price of approximately US\$4.3 billion, including the assumption of approximately US\$1.8 billion of debt on closing. The purchase price of \$60.25 per common share represents a premium over book value of approximately 31.4 percent.

Staff recommends approval of the merger subject to certain conditions. These conditions include:

1. Ratepayer Benefits/Savings – UNS Energy shall be required to establish a regulatory liability in the amount of \$60 million for the benefit of the ratepayers in future proceedings. This is intended to represent a 90 percent/10 percent sharing of the benefits to be derived from the proposed transaction between the shareholders and the ratepayers, respectively. This shall include a one-time bill credit totaling \$12 million to retail customers of the regulated entities<sup>1</sup> and shall be deducted against the regulatory liability. The amounts payable to each respective customer group will be calculated proportionately based on each group's respective monthly minimum charges and be credited monthly over six months starting in January 2015.
2. Ring Fencing - Appropriate ring fencing measures as discussed below shall be implemented to protect each regulated entity and its ratepayers from any financial distress that may be incurred by the Fortis or its other affiliates. These shall include but are not limited to maintaining the existence of separate capital structures, the establishment of a 'golden share' held by one independent director residing in Arizona (the consent of which would be required in order for UNS Energy to file for voluntary bankruptcy protection), the establishment of an independent Board of Directors for UNS Energy, dividend restrictions, and prohibitions on intercompany loans and guarantees burdening UNS Energy.
3. Annual reporting of ring fencing measures - Conditions contained herein shall be tracked and reported on for a period of 5 years. UNS Energy will file a report in Docket Control by April 1 of each year, beginning April 1, 2016, reporting on the prior calendar year's status of the conditions. The report will, at a minimum, provide a description of the performance of each condition that has quantifiable results. If any condition is not being met, the report shall provide proposed corrective measures and target dates for completion of such measures.
4. UNS Energy and its regulated entities shall each obtain Commission approval before distributing any monies from the regulated entities to Fortis above a specified amount for 5 years after the closing. Staff has not yet determined the appropriate amount, however, Staff will supplement its pre-filed testimony to provide a specified amount for each entity.
5. UNS Energy shall maintain a capital structure that is separate from that of Fortis.

---

<sup>1</sup> "Regulated entity" or "Regulated entities" are defined to mean those regulated utilities of UNS Energy, namely Tucson Electric Power Company, UNS Electric, Inc., and UNS Gas, Inc.

6. Fortis shall appoint a Board of Directors no later than one year after the closing. A majority of the directors shall have permanent residence in Arizona and shall have been permanent residents for at least 3 years prior to appointment. A majority of directors of UNS Energy shall be independent.
7. The corporate headquarters for UNS Energy will remain in Arizona.
8. Fortis shall establish a 'golden share' held by one independent director with permanent residence in Arizona. The consent of the holder of the golden share would be required in order for UNS Energy or any of its regulated entities to file for voluntary bankruptcy protection.
9. UNS Energy and the regulated entities shall not pledge or encumber any assets for the benefit of Fortis or Fortis' other affiliates, nor shall the regulated entities guarantee any indebtedness of Fortis or Fortis' other affiliates.
10. Fortis shall take notice of and agrees to fully comply with applicable Arizona and federal statutes and Commission rules including, without limitation, the affiliated interest rules as set forth in the Arizona Administrative Code.
11. Fortis affirmatively acknowledges the need to secure Commission approval when incurring debt, issuing equity instruments, and selling assets of the regulated entities.
12. Fortis acknowledges the potential impact of future acquisitions on the regulated entities and agrees that the Commission may establish additional requirements to protect the regulated entities, as deemed necessary by the Commission.
13. UNS Energy will not share customer specific information with Fortis affiliates for purposes other than the management of UNS Energy and the regulated entities and provision of electric and/or natural gas service to customers. Fortis shall secure confidentiality agreements from any affiliate with which it shares customer information. Fortis is on notice of a rule making docket in Docket No. RU-00000A-14-0014 regarding the sharing of customer information.
14. There shall be no sale or transfer of ownership of UNS Energy or any of its components for 5 years after the closing. Fortis acknowledges that Commission approval must be obtained in advance for any sale or transfer of ownership that occurs after 5 years of the closing.
15. Fortis, UNS Energy and/or the regulated entities shall not seek recovery of or on the acquisition premium in any future rate proceeding.
16. Fortis, UNS Energy, and/or the regulated entities shall not seek recovery of or on the transaction and transition costs associated with the merger, including any amounts paid to executives who leave employment within 5 years after the closing, any amounts paid as retention bonuses or other compensation, and any amount paid as severance to any employee. This shall apply for a period of 5 years after the closing.
17. Fortis, UNS Energy, and/or the regulated entities shall not include in the regulated entities' revenue requirement any increase in salaries of Senior Management Personnel<sup>2</sup> for a period of 5 years after the close of the proposed transaction.
18. Any plan for a reduction in force of existing employees by the regulated entities of UNS Energy through actions other than normal course of business or attrition, or for the relocation of non-Senior Management Personnel outside of Arizona, will be filed with the Commission, identifying the timing and economic justification for such plans for a reduction in force. Fortis agrees to file any intent to make reductions in its work force at least 120 days before implementing the plan.

---

<sup>2</sup> "Senior Management Personnel" shall include the positions held by the 11 existing executives.

19. Any plan for a significant adjustment to fringe benefits shall be filed with the Commission at least 120 days before implementing the plan.
20. Any plan for significant adjustment to wages and benefits paid to UNS Energy's 650 contract workers shall be filed with the Commission at least 120 days before implementing the plan.
21. Fortis shall not allocate any Fortis specific costs to the regulated entities for possible recovery in a future rate proceeding for 5 years after the closing. Fortis shall file notice of any intent to use a shared services model whereby central office or general office costs would be allocated to the regulated entities. Fortis and UNS Energy shall file a code of conduct regarding affiliate transactions within 30 days after the closing. Fortis and UNS Energy shall file with the Commission within 30 days after the close of the proposed transaction its procedures for managing any intercompany transactions.
22. Fortis and UNS Energy will ensure that sufficient Senior Management Personnel will be physically located in Arizona on a continuing basis to make decisions on behalf of UNS Energy pertaining to Arizona retail customer service issues.
23. Fortis and UNS Energy shall file for Commission approval within 30 days after the close of the proposed transaction its proposed procedures for valuing and allocating intercompany transactions related to the transfer of assets and to the provision of goods and services to and between affiliates. The Company's proposed procedures could involve making appropriate updates to Tucson Electric Power Company's existing Commission approved Code of Conduct.
24. UNS Energy will maintain its own accounting books and records separate from Fortis'. All UNS Energy financial books and records will be kept in Arizona. UNS Energy's financial books and records and state and federal utility regulatory filings and documents will continue to be available to the Commission and Staff upon request, at UNS Energy's Arizona offices.
25. Fortis will provide the Commission and Staff full access to all books of accounts, as well as all documents, data and records of their affiliated interests.
26. Fortis, UNS Energy, and their subsidiaries shall make their employees, officers, and agents available to testify before the Commission to provide information relevant to the matters within the jurisdiction of the Commission.
27. Fortis acknowledges that any amounts approved in future proceedings including but not limited to income tax expense, cost of equity, rate of return, and capital structures are in the sole discretion of the Commission.
28. In all rate cases filed by the regulated entities through 2020, the regulated entities shall demonstrate that the proposed rate increases are materially lower than those that would have been proposed absent the acquisition of UNS Energy by Fortis.
29. Fortis agrees to cooperate fully with the Commission's or Staff's audits of the accounting records of UNS Energy, the regulated entities, and Fortis and its subsidiaries relevant to matters within the jurisdiction of the Commission.
30. The regulated entities agree to reasonably evaluate long term power purchase and tolling agreements when preparing future resource plans, including those required by Commission rule, and selecting supply side resources in a manner that is consistent with applicable statutes and regulations so that the Commission can make a proper assessment between alternative resources, including comparison against company owned proposals.
31. UNS Energy's regulated entities shall maintain their quality of service based upon the following criteria until otherwise directed by the Commission: Tucson Electric Power and UNS Electric shall maintain a rolling three year average System Average Interruption Duration Index ("SAIDI"), System Average Interruption Frequency Index ("SAIFI"), and

Customer Average Interruption Duration Index ("CAIDI") at a maximum of the three year averages for each of those measures for the period 2011 through 2013 as reported to the Commission in Docket Nos. E-00000A-11-01113 and E-00000V-13-0070. UNS Gas shall maintain a rolling three year average number of customer complaints with the Commission's Consumer Services group at a maximum of the three year average of number of complaints for the period 2011 through 2013.

32. Fortis shall hold the regulated entities' ratepayers harmless from the impacts of any fluctuations in foreign exchange rates and any incremental taxes arising from its international ownership structure.
33. Fortis may infuse equity to include \$219 million for the purchase of Gila River Block 3, \$65 million for the purchase of Springerville Unit 1, and \$73 million for Springerville coal handling facilities. If any of these anticipated purchases does not materialize, the required equity infusion shall be reduced accordingly. However, in no event shall Fortis infuse less than \$200 million into the regulated entities. Fortis acknowledges that the prudence of any of these planned purchases is not being determined at this time, but shall be reviewed in a future rate proceeding.

1     **INTRODUCTION**

2     **Q.     Please state your name, occupation, and business address.**

3     A.     My name is Gerald Becker. I am an Executive Consultant III employed by the Arizona  
4           Corporation Commission ("Commission") in the Utilities Division ("Staff"). My business  
5           address is 1200 West Washington Street, Phoenix, Arizona 85007.

6  
7     **Q.     Briefly describe your responsibilities as an Executive Consultant III.**

8     A.     I am responsible for the examination and verification of financial and statistical information  
9           included in utility rate applications. In addition, I develop revenue requirements, and prepare  
10          written reports, testimonies, and schedules that include Staff recommendations to the  
11          Commission. I am also responsible for testifying at formal hearings on these matters.

12  
13    **Q.     Please describe your educational background and professional experience.**

14    A.     I received a Masters of Business Administration with an emphasis in Accounting from Pace  
15          University. I am a Certified Public Accountant and a Certified Internal Auditor. I am a  
16          member of the Arizona State Society of Certified Public Accountants.

17  
18          I have participated in multiple rate, financing and other regulatory proceedings. I attended  
19          the National Association of Regulatory Utility Commissioners ("NARUC") Utilities Rate  
20          School.

21  
22          I began employment with the Commission as a utilities regulatory analyst in April 2006. Prior  
23          to joining the Commission, I worked as an Auditor at the Department of Economic Security  
24          and Department of Revenue in the Taxpayer Assistance Section. Prior to those jobs, I  
25          worked for 15 years as an Auditor, Analyst, Financial Analyst, and Budget Manager at United  
26          Illuminating, an investor-owned electric company in New Haven, CT.

1 Q. What is the scope of your testimony in this case?

2 A. On January 24, 2014, UNS Energy Corporation ("UNS Energy") on behalf of itself and its  
3 affiliates, UniSource Energy Services, Inc., Tucson Electric Power Company, UNS Electric,  
4 Inc. and UNS Gas, Inc., and Fortis Inc. ("Fortis") on behalf of itself and its affiliates,  
5 FortisUS Holdings Nova Scotia Limited, FortisUS Inc., and Color Acquisition Sub Inc. filed  
6 an application to reorganize UNS Energy whereby Fortis would acquire UNS Energy for  
7 US\$60.25 per common share in cash, representing an aggregate purchase price of  
8 approximately US\$4.3 billion, including the assumption of approximately US\$1.8 billion of  
9 debt on closing. The purchase price of \$60.25 per common share represents a premium of  
10 31.4 percent over the closing market price per share of UNS common stock of \$45.84 the day  
11 news of the acquisition was made public on December 11, 2013  $((60.25 - \$45.84) / \$45.84 =$   
12  $31.4\%)$ . I am presenting Staff's recommendations regarding the purchase of UNS Energy by  
13 Fortis.  
14

15 Q. What is the basis of your recommendations?

16 A. I have reviewed the joint application of UNS Energy and Fortis whereby Fortis would acquire  
17 UNS Energy. I compared the application with the terms and conditions attached to  
18 reorganizations approved by the Commission and other regulatory bodies to ensure proper  
19 safeguards to protect the ratepayers and shareholders along with evaluating the amount of  
20 benefits that would accrue to the ratepayers as a result of the proposed reorganization.  
21

## 22 SUMMARY OF TESTIMONY AND RECOMMENDATIONS

23 Q. Please summarize Staff's recommendations.

24 A. Staff recommends approval of the merger subject to certain conditions which are intended to  
25 benefit and protect ratepayers. These conditions include:

- 1           1. Ratepayer Benefits/Savings – UNS Energy shall be required to establish a regulatory  
2           liability in the amount of \$60 million for the benefit of the ratepayers in future  
3           proceedings. This is intended to represent a 90 percent/10 percent sharing of the  
4           benefits to be derived from the proposed transaction between the shareholders and the  
5           ratepayers, respectively. This shall include a one-time bill credit totaling \$12 million to  
6           retail customers of the regulated entities<sup>3</sup> and shall be deducted against the regulatory  
7           liability. The amounts payable to each respective customer group will be calculated  
8           proportionately based on each group's respective monthly minimum charges and be  
9           credited monthly over six months starting in January 2015.
- 10          2. Ring Fencing - Appropriate ring fencing measures as discussed below shall be  
11          implemented to protect each regulated entity and its ratepayers from any financial distress  
12          that may be incurred by Fortis or its other affiliates. These shall include but are not  
13          limited to maintaining the existence of separate capital structures, the establishment of a  
14          'golden share' held by one independent director residing in Arizona, (the consent of  
15          which would be required in order for UNS Energy to file for voluntary bankruptcy  
16          protection), the establishment of an independent Board of Directors for UNS Energy,  
17          dividend restrictions, and prohibitions on intercompany loans and guarantees burdening  
18          UNS Energy.
- 19          3. Annual reporting of ring fencing measures - Conditions contained herein shall be tracked  
20          and reported on for a period of 5 years. UNS Energy will file a report in Docket Control  
21          by April 1 of each year, beginning April 1, 2016, reporting on the prior calendar year's  
22          status of the conditions. The report will, at a minimum, provide a description of the  
23          performance of each condition that has quantifiable results. If any condition is not being  
24          met, the report shall provide proposed corrective measures and target dates for  
25          completion of such measures.

---

<sup>3</sup> "Regulated entity" or "Regulated entities" are defined to mean those regulated utilities of UNS Energy, namely Tucson Electric Power Company, UNS Electric, Inc., and UNS Gas, Inc.

- 1           4. UNS Energy and its regulated entities shall each obtain Commission approval before  
2           distributing any monies from the regulated entities to Fortis above a specified amount for  
3           5 years after the closing. Staff has not yet determined the appropriate amount, however,  
4           Staff will supplement its pre-filed testimony to provide a specified amount for each entity.
- 5           5. UNS Energy shall maintain a capital structure that is separate from that of Fortis.
- 6           6. Fortis shall appoint a Board of Directors no later than one year after the closing. A  
7           majority of the directors shall have permanent residence in Arizona and shall have been  
8           permanent residents for at least 3 years prior to appointment. A majority of directors of  
9           UNS Energy shall be independent.
- 10          7. The corporate headquarters for UNS Energy will remain in Arizona.
- 11          8. Fortis shall establish a 'golden share' held by one independent director with permanent  
12          residence in Arizona. The consent of the holder of the golden share would be required in  
13          order for UNS Energy or any of its regulated entities to file for voluntary bankruptcy  
14          protection.
- 15          9. UNS Energy and the regulated entities shall not pledge or encumber any assets for the  
16          benefit of Fortis or Fortis' other affiliates, nor shall the regulated entities guarantee any  
17          indebtedness of Fortis or Fortis' other affiliates.
- 18          10. Fortis shall take notice of and agrees to fully comply with applicable Arizona and federal  
19          statutes and Commission rules including, without limitation, the affiliated interest rules as  
20          set forth in the Arizona Administrative Code.
- 21          11. Fortis affirmatively acknowledges the need to secure Commission approval when  
22          incurring debt, issuing equity instruments, and selling assets of the regulated entities.
- 23          12. Fortis acknowledges the potential impact of future acquisitions on the regulated entities  
24          and agrees that the Commission may establish additional requirements to protect the  
25          regulated entities, as deemed necessary by the Commission.



- 1           13. UNS Energy will not share customer specific information with Fortis affiliates for  
2           purposes other than the management of UNS Energy and the regulated entities and  
3           provision of electric and/or natural gas service to customers. Fortis shall secure  
4           confidentiality agreements from any affiliate with which it shares customer information.  
5           Fortis is on notice of a rule making docket in Docket No. RU-00000A-14-0014 regarding  
6           the sharing of customer information.
- 7           14. There shall be no sale or transfer of ownership of UNS Energy or any of its components  
8           for 5 years after the closing. Fortis acknowledges that Commission approval must be  
9           obtained in advance for any sale or transfer of ownership that occurs after 5 years of the  
10          closing.
- 11          15. Fortis, UNS Energy and/or the regulated entities shall not seek recovery of or on the  
12          acquisition premium in any future rate proceeding.
- 13          16. Fortis, UNS Energy and/or the regulated entities shall not seek recovery of or on the  
14          transaction and transition costs associated with the merger, including any amounts paid to  
15          executives who leave employment within 5 years after the closing, any amounts paid as  
16          retention bonuses or other compensation, and any amount paid as severance to any  
17          employee. This shall apply for a period of 5 years after the closing.
- 18          17. Fortis, UNS Energy, and/or the regulated entities shall not include in the regulated  
19          entities' revenue requirement any increase in salaries of Senior Management Personnel<sup>4</sup>  
20          for a period of 5 years after the close of the proposed transaction.
- 21          18. Any plan for a reduction in force of existing employees by the regulated entities of UNS  
22          Energy through actions other than normal course of business or attrition, or for the  
23          relocation of non-Senior Management Personnel outside of Arizona, will be filed with the  
24          Commission, identifying the timing and economic justification for such plans for a

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<sup>4</sup> "Senior Management Personnel" shall include the positions held by the 11 existing executives.

1 reduction in force. Fortis agrees to file any intent to make reductions in its work force at  
2 least 120 days before implementing the plan.

3 19. Any plan for a significant adjustment to fringe benefits shall be filed with the Commission  
4 at least 120 days before implementing the plan.

5 20. Any plan for significant adjustment to wages and benefits paid to UNS Energy's 650  
6 contract workers shall be filed with the Commission at least 120 days before  
7 implementing the plan.

8 21. Fortis shall not allocate any Fortis specific costs to the regulated entities for possible  
9 recovery in a future rate proceeding for 5 years after the closing. Fortis shall file notice of  
10 any intent to use a shared services model whereby central office or general office costs  
11 would be allocated to the regulated entities. Fortis and UNS Energy shall file a code of  
12 conduct regarding affiliate transactions within 30 days after the closing. Fortis and UNS  
13 Energy shall file with the Commission within 30 days after the close of the proposed  
14 transaction its procedures for managing any intercompany transactions.

15 22. Fortis and UNS Energy will ensure that sufficient Senior Management Personnel will be  
16 physically located in Arizona on a continuing basis to make decisions on behalf of UNS  
17 Energy pertaining to Arizona retail customer service issues.

18 23. Fortis and UNS Energy shall file for Commission approval within 30 days after the close  
19 of the proposed transaction its proposed procedures for valuing and allocating  
20 intercompany transactions related to the transfer of assets and to the provision of goods  
21 and services to and between affiliates. The Company's proposed procedures could  
22 involve making appropriate updates to Tucson Electric Power Company's existing  
23 Commission approved Code of Conduct.

24 24. UNS Energy will maintain its own accounting books and records separate from Fortis'.  
25 All UNS Energy financial books and records will be kept in Arizona. UNS Energy's  
26 financial books and records and state and federal utility regulatory filings and documents

1 will continue to be available to the Commission and Staff upon request, at UNS Energy's  
2 Arizona offices.

3 25. Fortis will provide the Commission and Staff full access to all books of accounts, as well  
4 as all documents, data and records of their affiliated interests.

5 26. Fortis, UNS Energy, and their subsidiaries shall make their employees, officers, and  
6 agents available to testify before the Commission to provide information relevant to the  
7 matters within the jurisdiction of the Commission.

8 27. Fortis acknowledges that any amounts approved in future proceedings including but not  
9 limited to income tax expense, cost of equity, rate of return, and capital structures are in  
10 the sole discretion of the Commission.

11 28. In all rate cases filed by the regulated entities through 2020, the regulated entities shall  
12 demonstrate that the proposed rate increases are materially lower than those that would  
13 have been proposed absent the acquisition of UNS Energy by Fortis.

14 29. Fortis agrees to cooperate fully with the Commission's or Staff's audits of the accounting  
15 records of UNS Energy, the regulated entities, and Fortis and its subsidiaries relevant to  
16 matters within the jurisdiction of the Commission.

17 30. The regulated entities agree to reasonably evaluate long term power purchase and tolling  
18 agreements when preparing future resource plans, including those required by  
19 Commission rule, and selecting supply side resources in a manner that is consistent with  
20 applicable statutes and regulations so that the Commission can make a proper assessment  
21 between alternative resources, including comparison against company owned proposals.

22 31. UNS Energy's regulated entities shall maintain their quality of service based upon the  
23 following criteria until otherwise directed by the Commission: Tucson Electric Power  
24 and UNS Electric shall maintain a rolling three year average System Average Interruption  
25 Duration Index ("SAIDI"), System Average Interruption Frequency Index ("SAIFI"),  
26 and Customer Average Interruption Duration Index ("CAIDI") at a maximum of the

1 three year averages for each of those measures for the period 2011 through 2013 as  
2 reported to the Commission in Docket Nos. E-00000A-11-01113 and E-00000V-13-  
3 0070. UNS Gas shall maintain a rolling three year average number of customer  
4 complaints with the Commission's Consumer Services group at a maximum of the three  
5 year average of number of complaints for the period 2011 through 2013.

6 32. Fortis shall hold the regulated entities' ratepayers harmless from the impacts of any  
7 fluctuations in foreign exchange rates and any incremental taxes arising from its  
8 international ownership structure.

9 33. Fortis may infuse equity to include \$219 million for the purchase of Gila River Block 3,  
10 \$65 million for the purchase of Springerville Unit 1, and \$73 million for Springerville coal  
11 handling facilities. If any of these anticipated purchases does not materialize, the required  
12 equity infusion shall be reduced accordingly. However, in no event shall Fortis infuse less  
13 than \$200 million into the regulated entities. Fortis acknowledges that the prudence of  
14 any of these planned purchases is not being determined at this time, but shall be reviewed  
15 in a future rate proceeding.

16  
17 Some of these conditions are discussed in greater detail below.  
18

19 **Q. Has Fortis acquired other utilities?**

20 **A.** Yes. Fortis owns several utilities in Canada, the United States and overseas. On June 27,  
21 2013, Fortis acquired CH Energy Group, parent company of Central Hudson Gas and  
22 Electric Corp. for \$65 per share in cash, which according to its news release, represented a  
23 13.1 percent above its most recent 20-day trading average of \$57.49 per share. The  
24 acquisition provides nearly \$50 million in ratepayer benefits<sup>5</sup>, including:

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<sup>5</sup> Per CH Energy Group, Inc., news release dated May 6, 2013.

- \$35 million to offset costs associated with restoring electric service to customers following major storms and to mitigate other expenses that would normally be included in future delivery rates;
- \$9.25 million in guaranteed savings by customers during the course of the next five years alone once the expenses associated with being a publicly traded company end;
- \$5 million set aside in a Customer Benefit Fund to be used for economic development and low income assistance programs for communities and residents of the Mid-Hudson Valley;
- Customer delivery rates will be frozen until July 1, 2014;
- Customers will continue to work with current employees, as all jobs at Central Hudson will be retained;
- Financial protections for CH Energy Group, Central Hudson and its customers as part of the larger Fortis organization; and
- A transition within the Board of Directors of Central Hudson to increase members from New York State and the Hudson Valley within one year.

**Q. How does the acquisition of CH Energy Group compare with the proposed purchase of UNS Energy?**

**A.** Based on information contained in Fortis' 8-K disclosure, the total assets associated with the CH Energy Group are approximately \$1.8 billion and the total assets of UNS Energy are projected to be \$4.3 billion, or almost 2.4 times the asset value of the CH Energy Group. See Attachment A.

**Q. Is Staff aware of any other recent transactions?**

**A.** Yes. On May 29, 2013, Berkshire Hathaway announced its plans to acquire NV Energy for \$23.75 per share, approximately 23.2 percent more than the closing price of \$19.28 on the previous day.

**Q. Has Staff reviewed the valuation of the proposed acquisition by Fortis?**

**A.** Yes. Information regarding the proposed reorganization became publicly available on or about December 12, 2013. A review of publicly available closing prices for UNS Energy on the New York Stock Exchange indicates a closing price of \$45.84 per share on December 11,

1 2013 and \$58.51 on December 12, 2013. After some small additional increases, the  
2 subsequent price of the stock has hovered around \$60 per share.

3  
4 UNS Energy has approximately 41.7 million shares of stock outstanding, which when  
5 multiplied by the stated purchase price of \$60.25 approximates the \$2.5 billion to be paid for  
6 the presently issued and outstanding share of UNS stock.

7  
8 **Q. What is the estimated premium on the price of the stock?**

9 A. Based on a review of the last known price of the stock prior to the announcement of the  
10 reorganization, Staff estimates the premium to be approximately \$600 million, or 31.4 percent  
11 of the previous market value of the stock, based on a comparison of the collective value of  
12 the outstanding shares at \$60.25 per share, or approximately \$2.5 billion, as compared with  
13 the valuation at \$45.84 per share, or approximately \$1.9 billion.

14

Number of Shares			Estimated Premium
Outstanding:	41,700,000	41,700,000	
Price	<u>\$60.25</u>	<u>\$45.84</u>	
Estimated Value	\$2,512,425,000	\$1,911,528,000	\$600,897,000, or 31.4%

15  
16  
17  
18  
19

20 **Q. Please explain the reasons that a valuation of the estimated premium is important.**

21 A. Staff presents this information to quantify the benefits that will accrue directly to the existing  
22 shareholders of the UNS Energy as a result of the proposed transaction. The value of this  
23 benchmark serves as a point of reference to value the benefits that should be shared with the  
24 ratepayers as a result of this transaction.

25

1     **Q.     Please describe the benefits expected for the ratepayers, per the application.**

2     A.     The application states that the ratepayers will benefit by UNS Energy being owned by a larger  
3           company with better access to capital. UNS Energy states that this *should* reduce future  
4           borrowing costs. However, this is not guaranteed in any way by Fortis or UNS Energy.

5  
6     **Q.     Does Staff believe that the application presents tangible and guaranteed benefits to**  
7           **the ratepayers?**

8     A.     No. The claim of reduced borrowing that should happen in the future is tenuous and not  
9           guaranteed or quantified. Furthermore, there are no known operational or financial  
10          challenges facing UNS Energy to be solved by the acquisition.

11  
12    **Q.     What is Staff's recommendation?**

13    A.     Given the magnitude of the premium being paid the existing shareholders of \$600 million  
14           and the lack of any other known benefits, Staff recommends that UNS Energy be required to  
15           establish a regulatory liability in the amount of \$60 million for the benefit of the ratepayers in  
16           future proceedings. This would be intended to represent a 90 percent / 10 percent sharing of  
17           the benefits to be derived from the proposed transaction between the shareholders and the  
18           ratepayers, respectively.

19  
20           The recommended benefit of \$60 million is only 20 percent higher than the estimated  
21           ratepayer benefits associated with the acquisition of the Central Hudson Group. The asset  
22           value of UNS Energy is almost 2.4 times the asset value of the Central Hudson Group.

23  
24           Staff further notes that the premium proposed in the UNS acquisition is 31.4 percent which  
25           compares with the 23.2 percent recently paid by Berkshire Hathaway for NV Energy. Fortis'  
26           willingness to pay a premium of this level further emphasizes the value accruing to the

1 shareholders by the proposed transaction and supports the appropriateness of sharing those  
2 benefits with the ratepayers.

3  
4 **RING FENCING**

5 **Q. Please describe the specific ring-fencing measures and their necessity.**

6 A. Ring fencing is defined as the legal walling off of a certain assets or liabilities within a  
7 corporation, as in a company forming a new subsidiary to protect (ring-fence) specific assets  
8 from creditors.<sup>6</sup> Ring fencing as a concept includes a number of measures that may be  
9 implemented to protect the economic viability of utility companies and their affiliates within a  
10 holding company structure. Ring-fencing measures are intended to insulate a regulated utility  
11 from the potentially riskier activities of an unregulated affiliate.<sup>7</sup> Insulating the utility is  
12 intended to ensure the financial stability of the utility and the reliability of its service.<sup>8</sup>

13  
14 Viability concerns can arise when vertically integrated generation-transmission-distribution  
15 companies change their corporate structure to conform to new market structures and  
16 regulatory requirements. Consequently, customers may be placed at risk in terms of  
17 continued reliable and reasonably price ("just and reasonable") electric or gas service.<sup>9</sup>

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<sup>6</sup> *Ring Fencing Mechanisms for Insulating a Utility in a Holding Company System*, prepared on behalf of the NARUC Staff Subcommittee on Accounting and Finance by Timothy Devlin, Florida Public Service Commission; Rebecca Phillips, Kentucky Public Service Commission; and Thomas Ferris, Wisconsin Public Service Commission; with the assistance of Chancy Bittner of the Iowa Utilities Board, David Hodgden and Joseph Buckley of the Ohio Public Utilities Commission, Charles Christiansen of the California Public Utilities Commission, and Terri Carlock of Idaho Public Utilities Commission. Available at: [http://regulationbodyofknowledge.org/wp-content/uploads/2013/03/Devlin\\_Ring\\_Fencing\\_Mechanisms.pdf](http://regulationbodyofknowledge.org/wp-content/uploads/2013/03/Devlin_Ring_Fencing_Mechanisms.pdf)

<sup>7</sup> Id.

<sup>8</sup> Id.

<sup>9</sup> Id.



1     **Q.     Does Staff believe that ring-fencing measures are appropriate in this case?**

2     A.     Yes. Fortis operates using a holding company structure and invests in regulated and  
3           unregulated enterprises. Accordingly, the ratepayers served by the regulated entities should  
4           be protected against any undue risk posed by Fortis' unregulated enterprises.

5  
6     **Q.     Please identify and explain those recommendations that Staff would categorize as**  
7           **supporting ring-fencing.**

8     A.     Ring-fencing measures include maintaining a separate capital structure, capital structure  
9           requirements, establishing a 'golden share' held by an independent director whose consent  
10          would be required to file for or be included in any voluntary bankruptcy proceeding, the  
11          establishment and maintenance of a separate Board of Directors for UNS Energy (the  
12          majority of whom shall reside in Arizona), monitoring and limiting the payment of dividends  
13          by UNS Energy, prohibitions on debt guaranteed by UNS Energy on behalf of Fortis or any  
14          of Fortis' affiliates and that Fortis takes full notice of statutes and Commission rules including  
15          but not limited to the issuance of debt and equity and the disposition of any utility assets.

16  
17          Separate capital structure – A separate capital structure helps to ensure the separateness of the  
18          utility from the parent and the effects of the parent's other regulated and unregulated  
19          businesses. This helps to establish its own Board of Directors separate from the Board of  
20          Directors for the parent company and enables the utility the ability to manage its own affairs.

21  
22          Capital Structure Restrictions – The application predicts post acquisition equity percentages  
23          of 44.1 percent, 45.0 percent, and 49.5 percent for UNS Energy (consolidated), Tucson  
24          Electric Power, and UNS Electric capital structures, respectively. Staff recommends that  
25          UNS Energy be required to maintain a capital structure for itself and its regulated subsidiaries  
26          that has no less equity than is predicted to exist at closing. UNS Energy would be required to

1 docket a report defining its actual capital structure for itself and its subsidiaries within 60 days  
2 after the close of the transaction.

3  
4 The establishment of a 'golden share' held by an independent director – The 'golden share'  
5 would serve to appoint an independent director with the fiduciary authority and sole authority  
6 under the charter, articles of incorporation, by-laws, or other governing documents of the  
7 utility to engage the utility in a voluntary filing for bankruptcy, in his or her sole discretion.

8  
9 Separate Board of Directors – To ensure local control and to enhance local interest, Staff  
10 recommends that UNS Energy have a separate Board of Directors, the majority of whom  
11 shall reside in Arizona. The application proposes that Fortis shall within one year of closing,  
12 appoint a Board of Directors for UNS Energy, the majority whom shall be independent with  
13 the majority of the independent directors shall reside in Arizona.<sup>10</sup> Since the proposed  
14 majority of a majority may not be able to exert control over Board's decisions, Staff  
15 recommends that the Board of Directors consist of an overall majority residing in the state of  
16 Arizona.

17  
18 Limitations on payments of dividends – To ensure that the regulated entities remain solvent  
19 and able to fund any capital needs appropriately from internally generated funds, Staff  
20 recommends that UNS Energy and its regulated entities shall each obtain Commission  
21 approval before distributing any monies from the regulated entities to UNS Energy or Fortis  
22 above a specified amount. Staff has not yet determined the appropriate amount. Staff will  
23 supplement its pre-filed testimony to provide a specified amount for each entity. This shall  
24 apply for a period of 5 years after closing.

25  

---

<sup>10</sup> Company application, testimony of Barry V. Perry, exhibit BVP-7 at 21.

1 Guarantees of debt – UNS Energy shall not lend to, guarantee or financially support Fortis or  
2 any of its other regulated or unregulated affiliates, or any subsidiary or joint venture of any  
3 affiliate, without the approval of the Commission.

4  
5 Issuances of debt and equity and sale or transfer of assets – Fortis takes full notice of Arizona  
6 Revised Statutes and Commission rules, regulations and policies including but not limited to  
7 the issuance of debt and equity and the sale of utility assets, without Commission approval.  
8 Staff further recommends that there shall be no sale or transfer of ownership of UNS Energy  
9 or any of its components for at least 5 years after the closing. Fortis acknowledges that  
10 Commission approval must be obtained in advance for any sale or transfer of ownership after  
11 5 years.

12  
13 **EQUITY**

14 **Q. Please describe the planned equity infusion to occur as a result of the reorganization.**

15 **A.** The application indicates that Fortis will infuse \$200 million in equity to cover certain  
16 planned expenditures. The total major planned expenditures of \$357 million include \$219  
17 million for the purchase of Gila River Block 3 in December 2014, \$65 million for the  
18 purchase of Springerville Unit 1 in January 2015, and \$73 million for Springerville coal  
19 handling facilities in April 2015. The \$200 million equity infusion would be combined with  
20 \$157 million of debt to fund the \$357 million of expenditures, and according to the  
21 application, the pre-acquisition and post- acquisition equity percentages would be 42.6  
22 percent and 44.1 percent, respectively<sup>11</sup>.

---

<sup>11</sup> Per the Company's calculations which do not consider obligations under capital leases as part of the overall indebtedness and results in the Company's equity percentage being higher.

1 **Q. Does Staff have any comments regarding the equity infusion and capital structures?**

2 A. Yes. Staff is concerned that the proposed equity percentages are not calculated in a manner  
3 that is consistent with the method used in a recent TEP financing application.<sup>12</sup> In Staff's  
4 analysis in Docket No. E-01933A-12-0176, Staff includes amounts owed under capital lease  
5 obligations as part of the overall equity structure and the Applicants did not.

6  
7 **Q. Does Staff have recommendations regarding the amount of equity to be infused?**

8 A. Yes. Staff recommends that Fortis be required to infuse the full amount that would be  
9 needed to include \$219 million for the purchase of Gila River Block 3, \$65 million for the  
10 purchase of Springerville Unit 1, and \$73 million for Springerville coal handling facilities.  
11 Staff further recommends that the resulting equity percentages be recalculated in a manner  
12 that is consistent with the analysis set forth in the Staff report in Docket No. E-01933A-12-  
13 0176. Staff will file supplemental testimony to provide the recalculated equity percentages.

14  
15 Using the Company's methodology, this would increase the post-acquisition equity  
16 percentage from 44.1 percent, per the application, to 49.3 percent.

17  
18 **Q. Based on the above, is Staff recommending that the Commission order the regulated  
19 entities and/or Fortis to make these purchases?**

20 A. No, that would be a management decision. The Commission will determine the prudence of  
21 such purchases, if they are completed, in future rate proceedings.

---

<sup>12</sup> See Docket No. E-01933A-12-0176. Staff report at 6, docketed November 2, 2012.

1     **CODE OF CONDUCT**

2     **Q.     Does Staff have any comments regarding a Code of Conduct policy?**

3     A.     Yes. Staff recommends that Fortis and UNS Energy file for Commission approval within 30  
4           days after the close of the proposed transaction their proposed procedures for valuing and  
5           allocating intercompany transactions related to the transfer of assets and to the provision of  
6           goods and services to and between affiliates. The proposed procedures could involve making  
7           appropriate updates to Tucson Electric Power Company's existing Commission approved  
8           Code of Conduct.

9  
10    **QUALITY OF SERVICE**

11   **Q.     Does Staff have any comments regarding Quality of Service?**

12   A.     Yes. UNS Energy's regulated entities shall maintain their quality of service based upon the  
13           following criteria until otherwise directed by the Commission: Tucson Electric Power and  
14           UNS Electric shall maintain a rolling three year average SAIDI, SAIFI, and CAIDI at a  
15           maximum of the three year averages for each of those measures for the period 2011 through  
16           2013 as reported to the Commission in Docket Nos. E-00000A-11-01113 and E-00000V-13-  
17           0070. UNS Gas shall maintain a rolling three year average number of customer complaints  
18           with the Commission's Consumer Services group at a maximum of the three year average of  
19           number of complaints for the period 2011 through 2013.

20  
21   **Q.     Does this conclude your direct testimony?**

22   A.     Yes, it does.

# The Fortis Family of Regulated Utilities

	Customers	Total Assets
Fortis BC	1,100,000	\$7.4B
UNIS Energy*	654,000	\$4.3B
Fortis Alberta	508,000	\$3.0B
Central Hudson	375,000	\$1.8B
Newfoundland Power	251,000	\$1.4B
Maritime Electric	76,000	\$0.5B
Fortis Ontario	64,000	\$0.3B
Caribbean Utilities	27,000	\$0.5B
Fortis Turks and Caicos	12,000	\$0.3B

\*Prospective



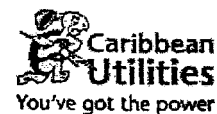
**FORTIS**  
ALBERTA



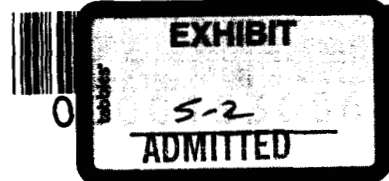
NEWFOUNDLAND  
**POWER**  
A FORTIS COMPANY

MARITIME  
**ELECTRIC**  
A FORTIS COMPANY

**FORTIS** ONTARIO



**FORTIS** TCI



BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED  
AZ CORPORATION  
DOCKET CONTROL

**COMMISSIONERS**

BOB STUMP - Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH

ORIGINAL 2014 JUN 2 PM 3 35

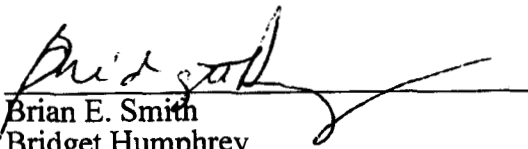
IN THE MATTER OF THE REORGANIZATION  
OF UNS ENERGY CORPORATION.

DOCKET NO. E-04230A-14-0011  
E-01933A-14-0011

**STAFF'S NOTICE OF FILING  
TESTIMONY IN SUPPORT OF THE  
SETTLEMENT AGREEMENT**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Testimony of Steven M. Olea in support of the Settlement Agreement in the above docket.

RESPECTFULLY SUBMITTED this 2<sup>nd</sup> day of June, 2014.

  
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Original and thirteen (13) copies  
of the foregoing filed this  
2<sup>nd</sup> day of June 2014 with:

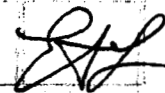
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1200 West Washington Street  
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Arizona Corporation Commission

**DOCKETED**

JUN 02 2014

DOCKETED BY



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mailed this 2<sup>nd</sup> day of June 2014 to:

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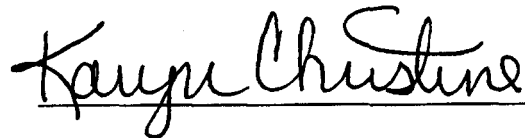


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**BRENDA BURNS**

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Commissioner

**SUSAN BITTER SMITH**

Commissioner

IN THE MATTER OF THE APPLICATION )  
FOR APPROVAL OF THE REORGANIZATION )  
OF UNS ENERGY CORPORATION ON )  
BEHALF OF ITSELF AND ITS AFFILIATES )  
UNISOURCE ENERGY SERVICES AND )  
TUCSON ELECTRIC POWER COMPANY )

---

DOCKET NOS. E-01933A-14-0011

E-04230A-14-0011

TESTIMONY

IN SUPPORT OF

THE PROPOSED SETTLEMENT AGREEMENT

STEVEN M. OLEA

DIRECTOR

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JUNE 2, 2014

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**EXECUTIVE SUMMARY  
UNS ENERGY CORPORATION  
DOCKET NOS. E-01933A-14-0011 AND E-04230A-14-0011**

Mr. Olea's testimony supports the adoption of the Settlement Agreement ("Agreement") as proposed by the Signatories in this case. This testimony describes the settlement process as open, candid, transparent and inclusive of all parties to this case. Mr. Olea explains the reasons the Agreement is in the public interest.

Mr. Olea's testimony recommends that the Commission adopt the Agreement as proposed.

**SECTION I – INTRODUCTION**

**Q. Please state your name and business address.**

A. Steven M. Olea, 1200 West Washington, Phoenix, Arizona, 85007.

**Q. By whom and in what capacity are you employed?**

A. I am employed by the Arizona Corporation Commission (“Commission”) as the Director of the Utilities Division.

**Q. Please state your educational background.**

A. I graduated from Arizona State University (“ASU”) in 1976 with a Bachelors Degree in Civil Engineering. From 1976 to 1978 I obtained 47 graduate hours of credit in Environmental Engineering at ASU.

**Q. Please state your pertinent work experience.**

A. From April 1978 to October 1978, I worked for the Engineering Services Section of the Bureau of Air Quality Control in the Arizona Department of Health Services (“ADHS”). My responsibilities were to inspect air pollution sources to determine compliance with ADHS rules and regulations.

From November 1978 to July 1982, I was with the Technical Review Unit of the Bureau of Water Quality Control (“BWQC”) in ADHS (this is now part of the Arizona Department of Environmental Quality (“ADEQ”). My responsibilities were to review water and wastewater construction plans for compliance with ADHS rules, regulations, and Engineering Bulletins.

1 From July 1982 to August 1983, I was with the Central Regional Office, BWQC, ADHS. My  
2 responsibilities were to conduct construction inspections of water and wastewater facilities to  
3 determine compliance with plans approved by the Technical Review Unit. I also performed  
4 routine operation and maintenance inspections to determine compliance with ADHS rules and  
5 regulations, and compliance with United States Environmental Protection Agency requirements.

6  
7 From August 1983 to August 1986, I was a Utilities Consultant/Water-Wastewater Engineer  
8 with the Utilities Division. My responsibilities were to provide engineering analyses of  
9 Commission regulated water and wastewater utilities for rate cases, financing cases, and  
10 consumer complaint cases. I also provided testimony at hearings for those cases.

11  
12 From August 1986 to August 1990, I was the Engineering Supervisor for the Utilities Division.  
13 My primary responsibility was to oversee the activities of the Engineering Section, which  
14 included one technician and eight Utilities Consultants. The Utilities Consultants included one  
15 Telecommunications Engineer, three Electrical Engineers, and four Water-Wastewater  
16 Engineers. I also assisted the Chief Engineer and performed some of the same tasks as I did as a  
17 Utilities Consultant.

18  
19 In August 1990, I was promoted to the position of Chief Engineer. My duties were somewhat  
20 the same as when I was the Engineering Supervisor, except that now I was less involved with the  
21 day-to-day supervision of the Engineering Staff and more involved with the administrative and  
22 policy aspects of the Engineering Section.

23  
24 In April 2000, I was promoted to the position of one of two Assistant Directors of the Utilities  
25 Division. In this position, I assisted the Division Director in the policy aspects of the Utilities  
26 Division. I was primarily responsible for matters dealing with water and energy.

1 In August 2009, I was promoted to my present position as Director of the Utilities Division. In  
2 this position, I manage the day-to-day operations of the Utilities Division with the assistance of  
3 the two Utilities Division Assistant Directors and oversee the management of the Utilities  
4 Division's Telecom & Energy Section, the Financial & Regulatory Analysis Section, the  
5 Consumer Services Section, the Engineering Section, the Compliance Section and the  
6 Administrative Section. In addition, I am responsible for making policy decisions for the  
7 Utilities Division.

8  
9 In early 2010, I was given the task of being the Interim Director for the Commission's Safety  
10 Division (Railroad and Pipeline). The day-to-day activities of the Safety Division were overseen  
11 by the managers of the Railroad Safety Section and the Pipeline Safety Section with input from  
12 me. Together with the Commission's Executive Director, I was responsible for the policy  
13 decisions for the Safety Division up until a permanent Safety Division Director was hired late in  
14 2012.

15  
16 **Q. What is the purpose of your testimony?**

17 A. The purpose of my testimony is to support the Proposed Settlement Agreement  
18 ("Agreement"). I will also provide testimony which addresses the settlement process, public  
19 interest benefits, substance of the Agreement and general policy considerations.

20  
21 **Q. How is your testimony being presented?**

22 A. My testimony is organized into four sections. Section I is this introduction, Section II  
23 provides discussion of the settlement process, Section III discusses the Agreement, and  
24 Section IV identifies and discusses the reasons why the Agreement is in the public interest.

1 Q. Will there be other Staff witnesses providing testimony?

2 A. No.

3  
4 **SECTION II – SETTLEMENT PROCESS**

5 Q. Did you participate in the negotiations that led to the execution of the Agreement?

6 A. Yes, I did.

7  
8 Q. Please discuss the settlement process.

9 A. The settlement process was open, transparent and inclusive. All parties received notice of the  
10 settlement meetings and were accorded an opportunity to raise, discuss, and propose  
11 resolution to any issue that they desired.

12  
13 Q. Who participated in those meetings?

14 A. All parties to the case participated except for Arizona Public Service Company, the City of  
15 Nogales and Sulphur Springs Valley Electric Cooperative.

16  
17 Q. Could you identify the interests that were involved in this process?

18 A. The interests included those of residential customers, low income customers, large customers,  
19 other electric utilities, renewable energy advocates, competitive power advocates,  
20 homebuilders, a labor union and energy efficiency advocates.

21  
22 Q. How many of these parties executed the Agreement?

23 A. All parties that participated in the settlement meetings except for Southwest Energy  
24 Efficiency Project, Navopache Electric Cooperative and Mohave Electric Cooperative signed  
25 the Agreement.

26



1 Q. Was there an opportunity for all issues of each participant to be discussed and  
2 considered?

3 A. Yes, each party had the opportunity to raise any issue and have it considered.  
4

5 Q. Were the Signatories able to resolve all issues?

6 A. Yes.  
7

8 Q. How would you describe the negotiations?

9 A. I believe that all participants zealously advocated and represented their interests. I would  
10 characterize the discussions as candid but professional. All parties had the opportunity to be  
11 heard and to have their positions fairly considered.  
12

13 Q. Would you describe the process as requiring give and take?

14 A. Yes, I would. As a result of the varied interests represented in the settlement process,  
15 willingness to compromise was necessary. As evidenced in the Agreement, the Signatories  
16 compromised on different litigation positions.  
17

18 Q. Because of such compromising, do you believe the public interest was compromised?

19 A. No. As I will discuss later in this testimony, I believe that the compromises made by the  
20 Signatories further the public interest.

**SECTION III – SETTLEMENT AGREEMENT**

**Q. Mr. Olea, you have indicated that the Agreement incorporates varied interests including those of the Applicants [UNS Energy Corporation (“UNS Energy”), UNS Energy Services, Inc. (“UES”), Tucson Electric Power Company (“TEP”), UNS Electric, Inc. (“UNS Electric”), UNS Gas, Inc. (“UNS Gas”), Fortis, Inc. (“Fortis”), FortisUS Holdings Nova Scotia Limited (“FortisUS Nova Scotia”), FortisUS Inc. (“FortisUS”), and Color Acquisition Sub Inc. (“Color Acquisition”)]; residential, industrial and commercial customers; energy efficiency and renewable energy groups; home builders; investors; mines; competitive providers; and community action groups. Please discuss how the Agreement addresses their interests.**

**A. As indicated in Section 1.8.a through Section 1.8.d, and as detailed in the Agreement, the Applicants agree to the following:**

- TEP, UNS Electric and UNS Gas (collectively the “Regulated Utilities”) shall provide \$30 million of direct customer benefits over 5 years through bill credits of which \$10 million will be payable in year 1 and \$5 million per year will be payable in years 2 through 5.
- To inject \$220 million of equity capital into UNS Energy for the benefit of the Regulated Utilities. This will enable the Regulated Utilities to become a part of a larger, more diverse and financially secure company with a stronger credit rating.
- To financially strengthen UNS Energy and the Regulated Utilities, and enhance the Regulated Utilities’ ability to provide safe, reliable and adequate service, improve their individual capital structures, and preserve or improve their credit ratings.
- To protect ratepayers by establishing appropriate ring fencing measures that will serve to protect each of the Regulated Utilities and its customers; and, improve access to capital markets that will enhance the Regulated Utilities’ ability to obtain sufficient capital to meet their needs, including access to debt capital at lower cost.
- To maintain existing employee levels and employee benefits at the Regulated Utilities for a period of at least 4 years, continue to perform under the existing collective bargaining agreements for the Regulated Utilities, and ensure that all future decisions on staffing, employment practices and labor relations at the Regulated Utilities continue to be made by local management of the Regulated Utilities;
- To retain existing senior management of UNS Energy and the Regulated Utilities in Arizona, and maintain their headquarters in Tucson, Arizona;

- 1 • To appoint a Board of Directors of UNS Energy, with oversight over UNS Energy and the  
2 Regulated Utilities, a majority of whom will be independent and a majority of whom will be  
3 resident in Arizona; and,  
4
- 5 • To continue to support low income assistance programs at or above current levels; sustain  
6 their contributions to charitable and community programs; and continue to provide energy  
7 efficiency and renewable energy programs as approved, or may be approved, by the  
8 Commission.  
9

10 **Q. Mr. Olea, are there any other issues that you would like to bring to the Commission's**  
11 **attention.**

12 **A. Yes. Among other things, Section H of the Attachment to the Agreement requires the**  
13 **Applicants to:**

- 14 • Prepare or amend the Code of Conduct for the Regulated Utilities similar to that which was  
15 previously approved for TEP.
- 16 • Maintain an up-to-date organizational chart.
- 17 • Provide various documents listed in Sections 6.5 of the Attachment to Staff and RUCO.
- 18 • Not seek relief from the Commission for any of the Conditions listed in the Agreement or  
19 Attachment thereto for at least five years.

20  
21 **Q. Mr. Olea, can you explain how the benefits listed above will be implemented?**

22 **A. Please see Attachment A to the Settlement which explains the implementation of the benefits**  
23 **and conditions**  
24

25 **SECTION IV – PUBLIC INTEREST**

26 **Q. Mr. Olea, is the Agreement in the public interest?**

27 **A. Yes, in Staff's opinion, the Agreement is fair, balanced, and in the public interest.**

1 Q. Would you summarize the reasons that lead Staff to conclude that the Agreement is  
2 fair, balanced, and in the public interest?

3 A. The Agreement provides a monetary benefit to ratepayers while at the same time providing  
4 the Regulated Utilities the opportunity to be part of a larger, well financed organization to  
5 enable the Regulated Utilities to not only maintain their existing safe, reliable and adequate  
6 service, but also improve this service.

7  
8 Q. Mr. Olea, do you believe that the Agreement results in benefits for consumers?

9 A. Yes. Among other benefits, the Agreement stipulates that there shall be a \$30 million benefit  
10 to ratepayers and no recovery of any acquisition adjustment or transition costs.

11  
12 Q. Mr. Olea, what was Staff's goal when it agreed to be a Signatory to the Agreement?

13 A. The primary goal of Staff in this matter, as in all proceedings before the Commission, is to  
14 protect the public interest. Staff believes it has accomplished this by reviewing the facts  
15 presented and making the appropriate recommendations to the Commission for its  
16 consideration. Staff believes the Agreement balances the interests of the Applicants and the  
17 ratepayers, by ensuring that the Regulated Utilities have the tools and financial health to  
18 provide safe, adequate and reliable service, while complying with Commission requirements  
19 of just and reasonable rates and protecting the Regulated Utilities and ratepayers from undue  
20 risk.

21  
22 Q. Is there anything else you would like to add regarding the Agreement?

23 A. I would like to reiterate that the settlement discussions were transparent, candid, professional  
24 and open to all parties in this docket. All parties were allowed to openly express their views  
25 and opinions on all issues. I believe the Agreement is in the public interest.

Testimony of Steven M. Olea

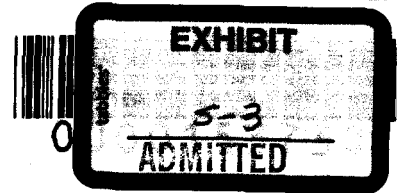
Docket Nos. E-01933A-14-0011 and E-04230A-14-0011

Page 9

1 Q. Does this conclude your testimony?

2 A. Yes, it does.

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**COMMISSIONERS**

BOB STUMP - Chairman

GARY PIERCE

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SUSAN BITTER SMITH

ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

DOCKETED BY

IN THE MATTER OF THE REORGANIZATION  
OF UNS ENERGY CORPORATION.

DOCKET NO. E-04230A-14-0011  
E-01933A-14-0011

**STAFF'S NOTICE OF ERRATA**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files its Notice of Errata regarding the Testimony in Support of the Proposed Settlement Agreement of Steven M. Olea filed on June 2, 2014. On page 4, lines 23 through 25, Mr. Olea listed the parties who participated in the settlement discussions but did not sign the Proposed Settlement Agreement. However, upon review it was noted that Solar Energy Industries Association also did not sign the Proposed Agreement but was inadvertently omitted from the list. Mr. Olea's testimony should have stated: "All parties that participated in the settlement meetings except for Southwest Energy Efficiency Project, Solar Energy Industries Association, Navopache Electric Cooperative and Mohave Electric Cooperative signed the Agreement."

In addition, Staff notes that a typographical error in Attachment A of the Proposed Settlement Agreement has an incorrect date. Attachment A of the Proposed Settlement Agreement states at page 1:

(c) All bill credits payable under subsections (a) and (b) hereof shall commence October 1st of each applicable year and be completed within six (6) months, i.e., by the following March 1st.

...

...

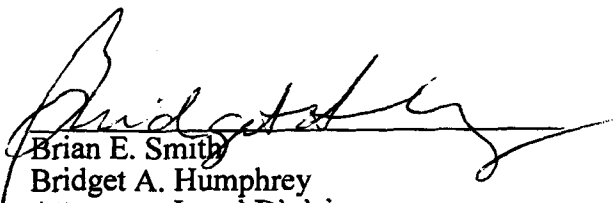
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...

1        Instead of "March 1<sup>st</sup>," this provision was intended to refer to "March 31<sup>st</sup>," as that comports  
2 with the six month period agreed to by parties signing the Agreement.

3        RESPECTFULLY SUBMITTED this 4<sup>th</sup> day of June, 2014.

4  
5  
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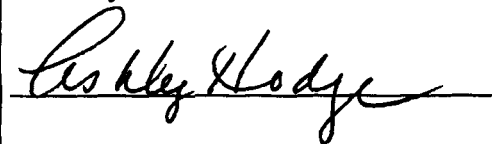
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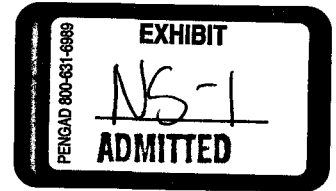
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28



# **Exhibit – Noble Solutions 1**

## **April 30, 2014 Direct Testimony of Greg Bass**

**UNS Energy and Fortis, Inc.**  
**Docket Nos. E-04230A-14-0011**  
**and E-01933A-14-0011**  
**June 16-17, 2014 Hearing**

LAWRENCE V. ROBERTSON, JR.  
ATTORNEY AT LAW  
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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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**GARY PIERCE**  
**BRENDA BURNS**  
**BOB BURNS**  
**SUSAN BITTER SMITH**

AZ CORP COMMISSION  
DOCKET CONTROL

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IN THE MATTER OF REORGANIZATION ) DOCKET NO. E-04230A-14-0011  
OF UNS ENERGY CORPORATION ) DOCKET NO. E-01933A-14-0011  
)  
) NOTICE OF FILING DIRECT  
) TESTIMONY ON BEHALF OF NOBLE  
) AMERICAS ENERGY SOLUTIONS LLC

Noble Americas Energy Solutions LLC ("Noble Solutions") hereby provides notice of filing of the Prepared Direct Testimony of Greg Bass on behalf of Noble Solutions in the above-docketed proceedings.

Dated this 29<sup>th</sup> day of April 2014.

Respectfully submitted,

Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.  
Attorney for Noble Americas Energy Solutions LLC

The original and thirteen (13) copies of the foregoing will be filed the 30<sup>th</sup> day of April 2014 with:

Docket Control Division  
Arizona Corporation Commission  
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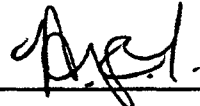
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DIRECT TESTIMONY

OF

GREG BASS

ON BEHALF OF NOBLE AMERICAS ENERGY SOLUTIONS LLC

DOCKET NO. E-04230A-14-0011

DOCKET NO. E-01933A-14-0011

**Q.1 Please state your name, business affiliation and business address.**

**A.1** My name is Greg Bass. I am Director of Retail Market Operations for Noble Americas Energy Solutions LLC ("Noble Solutions"), a retail energy service provider ("Supplier") serving retail end-use commercial and industrial customers throughout the United States of America and Mexico since 1999. My business address is 401 West A St., Suite 500, San Diego, California 92101.

**Q.2 Please summarize your professional background and experience.**

**A.2** I have been in the energy business since 1991 and have been working for Noble Solutions since 2000. Noble Solutions was previously known as Sempra Energy Solutions, LLC ("SES"). For my first 10 years, I worked for PacifiCorp in Portland, Oregon and Southern California Edison Company in Los Angeles, California. My professional background is in regulatory and legislative affairs. For Noble Solutions I have been involved in retail operations, retail licensing, and utility certification and set-up as well as my current role of responsibility for regulatory and legislative affairs for the West. My full resume is attached hereto as Exhibit GRB-1.

**Q.3 Have you previously testified before the Commission?**

**A.3** Yes. I provided testimony in Docket Number E-01933A-07-0401, a Tucson Electric Power Company rate case proceeding, in which I testified upon behalf of SES.

1  
2 **Q.4 Please describe Noble Solutions and the nature of the various products and services**  
3 **which it offers.**

4 **A.4** Noble Solutions is 100% owned by Noble Americas Gas & Power LLC, ("Noble  
5 Americas"), which in turn is 100% owned by Noble Group Ltd. ("Noble Group"). Noble  
6 Group is a market-leading global supply chain manager of agricultural and energy  
7 products, metals and minerals. Noble Group is listed in Singapore (SGX: N21), with  
8 headquarters in Hong Kong and operates from over 140 locations. Noble Group is ranked  
9 number 76 in the 2013 Fortune 500 list of companies. Noble Solutions offers a suite of  
10 commodity products and commodity services structured to meet the unique needs of energy  
11 users and to capture the benefits of choice at the retail level of electricity and natural gas  
12 consumption. These commodity products include fixed price, index price and renewable  
13 energy, and commodity services include Powerfolio 3D, Online Energy Analyzer and  
14 market reports. At present, Noble Solutions serves commercial and industrial customers  
15 and institutions of higher learning in (i) the states of California, Connecticut, Delaware,  
16 Illinois, Maine, Maryland, Massachusetts, Michigan, Nevada, New Hampshire, New  
17 Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island and Texas, (ii) the District of  
18 Columbia and (iii) also in Baja California, Mexico. In addition, Noble Solutions was  
19 nominated by the Texas Public Utilities Commission to act as a provider of last resort, a  
20 quasi-regulator service, for a number of years.

21  
22 **Q.5 Does Noble Solutions currently conduct any business within the State of Arizona; and,**  
23 **if so, what is the nature of such business(es)?**

24 **A.5** Yes. Noble Solutions is currently providing electric service to one (1) customer in the  
25 service area of Arizona Public Service Company ("APS") pursuant to APS' Experimental  
26 Rate Service Rider Schedule AG-1 ("Rate Schedule AG-1"), which was approved by the  
27 Commission in its Decision No. 73183.

1  
2 **Q.6 What is the nature of Rate Schedule AG-1?**

3 A.6 APS' Rate Schedule AG-1 is a four year program with a buy-through rate for large  
4 commercial and industrial customers offered as an option to standard generation service  
5 that gives larger customers greater control over their energy costs. This program was  
6 developed in response to customer input preceding and during APS' last rate case, and  
7 allows Generation Service Providers ("GSP") to provide wholesale power to APS on behalf  
8 of specific customers. Under Rate Schedule AG-1, APS purchases and manages generation  
9 service on behalf of the participating customer for a management fee of \$.0006 per Kwh.  
10 The program is "capped" at 200 MW, and participating customers must be able to  
11 aggregate into a 10 MW group.

12  
13 **Q.7 Was Rate Schedule AG-1 included among the provisions of the Settlement Agreement**  
14 **in APS' last rate case, which was approved by the Commission in Decision No. 73183?**

15 A.7 Yes. In that regard, in connection with its consideration of Rate Schedule AG-1, the  
16 Commission made the following observations:

17 "The Joint Signatories believe that the proposed Alternative Generation  
18 Rate Schedule ("AG-1") provides APS' large customers increased  
19 flexibility to manage their energy costs by creating an experimental buy-  
20 through rate option that will insulate all other customers from any cost  
21 shifting. Customers with an aggregated load of at least 10 MW may select  
22 a GSP and negotiate a price whereby APS will purchase the power from  
23 the GSP in a wholesale transaction and deliver the power to the customer.  
24 The program cap of 200 MW and the limited 4 year term will help limit  
25 any under-recovery of fixed costs, and APS is also required to take  
26 commercially reasonable steps (including maximizing off-system sales) to  
27 eliminate or mitigate any unrecovered costs resulting from the program.  
28 The Commission retains the ability to decide whether and how any  
unrecovered costs should be recognized in APS' next rate case. [Decision  
No. 73183 at page 30, lines 2-11]

26 **Q.8 Is Rate Schedule AG-1 different from retail electric competition?**

27 A.8 Yes. In fact, the Commission specifically addressed that question in Decision No. 73183:



1 "As explained by Noble/Constellation/Direct/Shell witness Lynch, the  
2 electric service provided under proposed rate schedule AG-1 differs from  
3 retail electric competition in that 'the GSP will transfer title to the  
4 electricity the GSP bought, at the direction of an eligible Rate Schedule  
5 AG-1 customer, to APS at a delivery point outside of APS' network  
6 delivery' and 'APS remains the load serving entity for the retail customer  
7 providing all services, including the generation delivery and billing under  
8 a Commission approved rate schedule.'" [Decision No. 73183 at page 24,  
9 lines 19-25]

10 **Q.9 How was Rate Schedule AG-1 implemented on APS' system?**

11 **A.9 As the Settlement Agreement contemplated, and as the Commission observed in Decision**  
12 **No. 73183,**

13 "A collaborative process will be [and was] used to develop program  
14 guidelines including the customer enrollment process, APS' provision of  
15 imbalance energy, energy scheduling and billing and competitive bidding  
16 processes." [Decision No. 73183 at page 24, lines 17-19]

17 **Q.10 In his January 24, 2014 prepared Direct Testimony in this proceeding, UNS Energy's**  
18 **Chairman and Chief Executive Officer, Paul J. Bonavia, discussed challenges and**  
19 **significant issues which confront UNS Energy and its Arizona utilities in the near**  
20 **future. Among the challenges he cited were (i) a need "to adapt to changes in**  
21 **customers' energy consumption needs and expectations," and (ii) a need "to offer**  
22 **customers a broader array of choices in price and quality of service." Against that**  
23 **background, does Noble Solutions believe that a Rate Schedule AG-1 type of program**  
24 **should be considered by UNS Energy and Fortis as part of a broad-based approach**  
25 **for responding to such near term future challenges?**

26 **A.10 Yes, without a doubt; and, an appropriate setting would be the next rate case(s) for Tucson**  
27 **Electric Power Company ("TEP") and UNS Electric, Inc. ("UNS Electric"), respectively.**  
28 **In that regard, Noble Solutions hopes that the senior management of UNS Energy and**  
**Fortis would be receptive to such a suggestion, and that they would indicate such**  
**receptiveness within the context of this proceeding.**

1 **Q.11 Why do you believe that an expression of such receptiveness at this point in time**  
2 **would be relevant to this proceeding?**

3 **A.11 Because, as Administrative Law Judge Jane L. Rodda observed in her March 10, 2014**  
4 **Procedural Order, in determining whether or not to approve the proposed reorganization (or**  
5 **merger), the Commission has the**

6 " . . . overarching obligation imposed by Article 15, § 3 of the Arizona  
7 Constitution, to consider the broad public interest." [March 10, 2014  
Procedural Order at page 5, lines 20.5 – 22.5]

8 In that regard, the willingness of both UNS Energy and Fortis to consider a Rate Schedule  
9 AG-1 type of program as a possible means for TEP and UNS Electric to address in the near  
10 term future the (i) need to "adapt to changes in customers' energy consumption needs and  
11 expectations," and the (ii) need "to offer customers a broader array of choices in price and  
12 quality of service," would appear to be directly relevant to the question of whether or not  
13 Commission approval of the proposed reorganization (or merger) would in fact be in the  
14 "broad public interest." In fact, in her March 10, 2014 Procedural Order, Judge Rodda  
15 expressly observed that

16 " . . . the ability of the management of the newly proposed entity to  
17 respond financially and philosophically to changing market conditions is  
18 part of the inquiry into the public interest and within the scope of this  
19 proceeding. . ." [March 10, 2014 Procedural Order at page 5, line 26 –  
page 6, line 2] [emphasis added]

20 **Q.12 As of this point in time, does Noble Solutions have any insight as to whether or not the**  
21 **senior management of UNS Energy and Fortis might be receptive to consideration of**  
22 **a Rate Schedule AG-1 type of program in connection with TEP's and UNS Electric's**  
23 **next rate case(s)?**

24 **A.12 Not as of this juncture. Presumably some insight in that regard will be obtained as this**  
25 **proceeding progresses, including during the settlement discussions that are scheduled to**  
26 **begin on May 5, 2014. However, we are aware of the existence of programs on Fortis'**  
27 **Fortis Alberta, Inc and Central Hudson Gas & Electric Corporation subsidiary utility**  
28

1 systems which appear to include customer choice options involving third-party service  
2 providers. To the extent Noble Solutions' understanding in that regard is correct, this  
3 would suggest that philosophical receptiveness on the part of Fortis to adapt to "changing  
4 market conditions" in the electric utility industry which we believe is to be desired.

5  
6 **Q.13 How does Noble Solutions perceive itself and the various services it offers vis-à-vis**  
7 **TEP and UNS Electric?**

8 **A.13** We believe that Judge Rodda was accurate in her observation in the March 10, 2014  
9 Procedural Order that Noble Solutions could be either

10 "... a potential competitor or business partner with the Arizona Utilities. .  
11 ." [March 10, 2014 Procedural Order at page 5, lines 14-15] [emphasis  
added]

12 Depending upon the circumstances, Noble Solutions could be either. But, in terms of  
13 assisting the Arizona Utilities (or TEP and UNS Electric) in responding to the near term  
14 future challenges of (i) adapting to changes in customers' energy consumption needs and  
15 expectations, and (ii) offering customers a broader array of choices in price and quality of  
16 service, Noble Solutions' believes that programs such as Rate Schedule AG-1 would offer  
17 a meaningful opportunity to "partner."

18  
19 **Q.14 Does Noble Solutions have a position as to whether or not the Commission should**  
20 **approve the proposed reorganization (or merger)?**

21 **A.14** Not as of this juncture.

22  
23 **Q.15 Does that complete your Direct Testimony?**

24 **A.15** Yes.  
25  
26  
27  
28

# **Exhibit GRB-1**

## **Greg Bass**

---

6541 Avenida Mafana, La Jolla, CA  
(858) 638-1514 • greg.bass@earthlink.net

### **PROFESSIONAL SUMMARY**

Director with regulatory and legislative policy experience, including business development and sales experience. Additional responsibilities have included business operations and development and implementation of strategic plans. Background includes:

- Regulatory & legislative strategy and policy
- Regulatory and business negotiation
- Operations plan creation, analysis and implementation
- Representation of legal and business interests
- Regulatory & legal compliance
- Expert witness and sponsor of testimony
- Contract creation and negotiation
- Analysis of regulatory proceedings and decisions

### **EXPERIENCE**

**Noble Americas Energy Solutions (formerly Sempra Energy Solutions), San Diego, California,**  
2000 – current

**Director, Retail Commodities Operations, 2004 – current**

• **Regulatory & Legislative Strategy and Policy:**

Develop and advocate Solutions' regulatory positions in select commission proceedings (state and FERC), hearings and settlement negotiations. This includes ex-parte meetings with commissioners, commission advisors and commission staff in order to educate public policy makers on the impact of their proposed policies on Solutions' business and customers and shape the outcome of public policy decisions in the business interest of Solutions. Manage internal and hire external legal counsel and consultants and direct participation in like minded trade groups.

Develop, advocate and shape the outcome of the legislative process as it impacts Solutions' business. This includes advising corporate legislative resources to lobby state assemblymembers and state senators to shape the language of proposed legislation so as to incorporate both Solutions' business interests as well as Sempra Energy's.

• **Regulatory & Legal Compliance:**

Responsible for the proper implementation and compliance with adopted legislation and regulatory decisions (both state and federal) as they relate to the retail and wholesale commodities business Solutions undertakes. Manage operations, legal, sales, and contracts to ensure compliance.

Create and manage systems and processes that monitor and interact with 13 state regulatory commissions, legislatures and relevant state laws. Manage operational capabilities in order to meet state and federal compliance requirements as it pertains to the commodity aspect of Solutions' business. This includes directing and engaging corporate legal, public affairs and regulatory resources as needed.

• **Regulatory and Business Negotiation, Expert Witness and Sponsor of Testimony:**

As needed, lead a cross-functional team that includes executive management, corporate management, corporate legal, and regulatory counsel in order to develop company policy and take regulatory positions in support of Solutions' business strategy. Lead and direct intervention in select proceedings, sponsor and create testimony, advocate and negotiate preferred public policy outcomes. Support Sales efforts by helping educate customers on service options and regulatory changes that affect their energy purchases.

**Achievements:**

- Directed and lead the Resource Adequacy Capacity strategy for Solutions that included effective participation and advocacy in the commission proceeding as well as development and management of multiple Resource Adequacy RFPs and contract negotiations with merchant generators and investor owned utilities. This successful strategy and effective implementation enabled Solutions to extract an additional \$6 million in gross margin in California for 2006.
- Successfully filed a complaint at FERC regarding PacifiCorp's OATT – saving Solutions over \$750,000 in gross margin.
- Negotiated retail sale agreements with power plants in Texas, creating \$500,000 a year in gross margin.
- Identified Oregon as a business opportunity, participated in the regulatory construct, directed Solutions to act with urgency resulting in over 200 MW of retail load with over \$2 million in gross margin per year.
- Negotiated a settlement with Detroit Edison to resolve an on going FERC dispute regarding provisions of their OATT. Saved Solutions over \$500,000 in gross margin.
- Entrusted with multiple responsibilities including structuring deals, negotiating contracts and terms of agreement, drafting detailed testimony and ensuring compliance with federal and state laws to maintain Solutions' power and gas licenses.

**Manager, Customer Activation, 2000 – 2004**

- Managed the portfolio of 12,000 power and gas customers ensuring that operational requirements and the integrity of the customer set-up information was complete, timely and accurate for billing purposes.
- Trained and directed Portfolio Analysts towards flawless execution.
- Created, developed, and maintained robust and efficient enrollment and customer set-up processes and systems and ensured that these processes and systems were in compliance with industry best practices.
- Created, developed, reviewed, and maintained a system of internal controls surrounding the set-up and activation processes of new customers.
- Managed the on going trading partner and vendor relationships required to be a retail power and gas provider.
- Resolved specific customer level inconsistencies, as they arose, by developing and maintaining key operational relationships both internally and externally.
- Evaluated potential vendors' sales offerings and capabilities, selected vendors that met Solutions' business needs and objectives and negotiated service agreements.

**Achievements:**

- Developed and successfully implemented an ISO 9001 compliant retail supplier mid-office that facilitated over \$350 million in gross margin.
- Negotiated ISDA, NASB and EEI wholesale supply and multiple vendor service contracts, agreements and other enabling documents.
- Awarded the Sempra Energy Chairman's Award in 2003 for business growth and achievement.

**Southern California Edison (SCE), Los Angeles, California, 1997 – 2000****Account Manager III**

- Managed the Electric Service Provider (ESP) relationship with SCE and acted as primary contact for NewEnergy, New West Energy, Enron Energy Services, and Sempra Energy Solutions.
- Communicated SCE's policies and procedures as they affected Electricity Service Providers and the deregulated retail electric marketplace.
- Obtained timely resolution of operational and policy issues in order to maintain high-levels of ESP satisfaction.
- Reviewed, analyzed, proposed and debated operational policies and procedures for national retail electric Uniform Business Practices developed at the Edison Electric Institute's consensus workshops.

**PacifiCorp**, Portland, Oregon, 1991 – 1997

**Senior Pricing Analyst**, 1995 – 1997

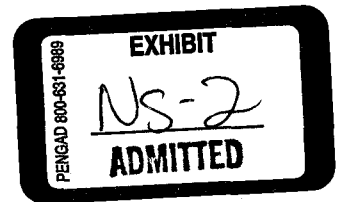
**Pricing Analyst**, 1992 – 1995

**Assistant Pricing Analyst**, 1991 – 1992

## **EDUCATION**

**Master of Business Administration**, Finance, 1990, University of San Diego

**Bachelor of Arts**, Economics, 1987, San Diego State University



# **Exhibit – Noble Solutions 2**

## **June 2, 2014 Testimony Relating to Settlement Agreement of Greg Bass**

**UNS Energy and Fortis, Inc.**  
**Docket Nos. E-04230A-14-0011**  
**and E-01933A-14-0011**  
**June 16-17, 2014 Hearing**



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**BEFORE THE ARIZONA CORPORATIC**

**COMMISSIONERS**

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**GARY PIERCE**  
**BRENDA BURNS**  
**BOB BURNS**  
**SUSAN BITTER SMITH**

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DOCKET NO. E-04230A-14-0011

DOCKET NO. E-01933A-14-0011

) NOTICE OF FILING TESTIMONY OF  
) GREG BASS ON BEHALF OF NOBLE  
) AMERICAS ENERGY SOLUTIONS LLC  
) IN SUPPORT OF PROPOSED  
) SETTLEMENT AGREEMENT

Noble Americas Energy Solutions LLC ("Noble Solutions") hereby provides notice of filing of the Testimony of Greg Bass on behalf of Noble Solutions In Support of Proposed Settlement Agreement in the above-docketed proceedings.

Dated this 2<sup>nd</sup> day of June 2014.

Respectfully submitted,

*Lawrence V. Robertson, Jr.*

Lawrence V. Robertson, Jr.  
Attorney for Noble Americas Energy Solutions LLC

The original and thirteen (13) copies of the foregoing will be filed the 2<sup>nd</sup> day of June 2014 with:

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TESTIMONY OF GREG BASS  
ON BEHALF OF NOBLE AMERICAS ENERGY SOLUTIONS LLC  
IN SUPPORT OF  
UNS ENERGY/FORTIS MERGER  
PROPOSED SETTLEMENT AGREEMENT  
DOCKET NO. E-04230A-14-0011  
DOCKET NO. E-01933A-14-0011

**Q.1 Please state your name, business affiliation and business address.**

**A.1** My name is Greg Bass. I am Director of Retail Market Operations for Noble Americas Energy Solutions LLC ("Noble Solutions"). My business address is 401 West A St., Suite 500, San Diego, California 92101.

**Q.2 Are you the same Greg Bass whose prepared Direct Testimony was filed in this proceeding with the Commission's Docket Control on April 30, 2014?**

**A.2** Yes, I am.

**Q.3 What is the purpose of the testimony you are submitting at this time?**

**A.3** I am testifying on behalf of Noble Solutions in support of the Settlement Agreement and related Settlement Conditions reached in this proceeding. That Settlement Agreement and related Settlement Conditions were filed with the Commission's Docket Control on May 16, 2014; and, Noble Solutions is a signatory party to the Settlement Agreement.

**Q.4 Did Noble Solutions participate in the negotiations and subsequent drafting which resulted in the Settlement Agreement and related Settlement Conditions?**

**A.4** Yes. I was in attendance throughout the settlement negotiations that were conducted in the Commissioners' Conference Room at the Commission's Offices in Phoenix on May 5, 2014. Thereafter, Noble Solutions' attorney of record in this proceeding and I reviewed the

1 draft language of the Settlement Agreement and related Settlement Conditions, as  
2 circulated by the Commission's Staff, and we offered such comment as we deemed  
3 necessary or appropriate from Noble Solutions' perspective. Finally, once the language of  
4 the Settlement Agreement and related Settlement Conditions had been agreed upon by all  
5 the parties who intended to become signatories, I executed the Settlement Agreement upon  
6 behalf of Noble Solutions.

7  
8 **Q.5 Why did Noble Solutions decide to sign and support the Settlement Agreement and**  
9 **related Settlement Conditions?**

10 **A.5** The reasons are both general in nature and specific to the interests of Noble Solutions.

11 From a general perspective, the Settlement Agreement and related Settlement  
12 Conditions reflect the results of good faith and arms length negotiations and balancing of  
13 interests among most of the parties to this proceeding. In that regard, Sections 1.7 and 5.1  
14 of the Settlement Agreement state:

15 "The terms of this Agreement are just, reasonable, fair, and in the  
16 public interest in that they provide a just and reasonable resolution  
17 of the issues arising from this Docket and, among other things,  
18 establish appropriate conditions to ensure quality of service by the  
19 Regulated Utilities, enhance the financial strength of UNS Energy  
20 and the Regulated Utilities, retain local control of the Regulated  
21 Utilities, improve access to capital for UNS Energy and the  
22 Regulated Utilities, and avoid unnecessary litigation expense and  
23 delay."

24 and

25 "This case has attracted a large number of participants with widely  
26 diverse interests. To achieve consensus for settlement, many  
27 participants are accepting positions that, in any other  
28 circumstances, they would be unwilling to accept. They are doing  
so because this Agreement, as a whole, is consistent with their  
long-term interests and with the broad public interest. The  
acceptance by any Signatory of a specific element of this  
Agreement shall not be considered as precedent for acceptance of  
that element in any other context."

In addition, from the perspective of the specific impact of Noble Solutions, the

1 Settlement Agreement and one (1) of the Settlement Conditions directly address a subject  
2 that I discussed in my previously filed prepared Direct Testimony in this proceeding. The  
3 remainder of the Settlement Conditions are either consistent with or not relevant to the  
4 interests of Noble Solutions.

5  
6 **Q.6 What was the subject you raised in your prepared Direct Testimony, and which**  
7 **Settlement Condition addresses that subject?**

8 **A.6** At page 4, lines 13-26 of my prepared Direct Testimony, I referred to the previously filed  
9 January 24, 2014 prepared Direct Testimony of UNS Energy's then Chief Executive  
10 Officer, Paul J. Bonavia, in which he discussed challenges and significant issues which  
11 confront UNS Energy and the Arizona Utilities in the near future. Among the challenges  
12 he cited were (i) a need "to adapt to changes in customers' energy consumption needs and  
13 expectations," and (ii) a need "to offer customers a broader array of choices in price and  
14 quality of service." Against that background, I suggested that a program similar to Arizona  
15 Public Service Company's current Rate Schedule AG-1 program should be considered by  
16 UNS Energy and Fortis as a part of a broad-based approach for responding to the  
17 challenges mentioned by Mr. Bonavia.

18 As a result of the subsequent settlement negotiations on May 5, 2014, the  
19 Settlement Agreement contains Settlement Condition No. 31, which provides as follows:

20 "In their next rate cases, TEP and UNSE will propose a pilot  
21 program for a 'buy through' tariff available to large light and  
22 power and large power service customers, respectively."

23 Noble Solutions is appreciative of this positive response by the settling parties, including  
24 UNS Energy and Fortis. In that regard, Noble Solutions intends to intervene in TEP's and  
25 UNSE's respective next rate cases; and, we look forward to the opportunity to review and  
26 comment upon such "buy through" pilot program(s) as each of those companies will be  
27 proposing. In that regard, Noble Solutions believes that the willingness of UNS Energy  
28 and Fortis to affirmatively commit TEP and UNSE proposing "buy through" programs in

1 their respective next rate cases is consistent with that "broad public interest" which the  
2 Commission will consider in this proceeding, incident to determining if the proposed  
3 merger should be approved.

4 In addition, Settlement Condition No. 41(iii) speaks in terms of UNS Energy and its  
5 affiliates continuing to support and, where appropriate, enhance "economic partnerships"  
6 and "consumer partnerships." As Administrative Law Judge Jane L. Rodda observed in her  
7 March 10, 2014 Procedural Order granting Noble Solutions' request for intervention in this  
8 proceeding, Noble Solutions could be either

9 "... a potential competitor or business partner with the Arizona  
10 Utilities." [emphasis added]

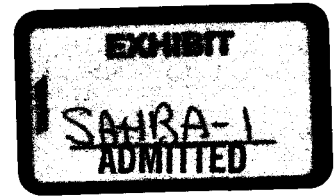
11 In this instance, with a properly structured and inclusive "buy through" program, Noble  
12 Solutions believes that the potential for it to "partner" with TEP and UNSE in the future in  
13 serving some of the requirements of some of those companies' customers for safe,  
14 reasonable and adequate service is quite good.

15  
16 **Q.7 Does Noble Solutions' execution and support for the Settlement Agreement and**  
17 **related Settlement Conditions mean that Noble Solutions would have no objection to a**  
18 **Commission decision approving the proposed merger?**

19 **A.7** Yes, provided that a final Commission decision did not alter the Settlement Agreement and  
20 related Settlement Conditions in such a manner as to be detrimental to the interests of  
21 Noble Solutions.

22 **Q.8 Does that conclude your testimony in support of the Settlement Agreement and**  
23 **related Settlement Conditions?**

24 **A.8** Yes, it does.  
25  
26  
27  
28



# **Exhibit – SAHBA 1**

**April 30, 2014 Direct Testimony of  
David Godlewski**

**UNS Energy and Fortis, Inc.**

**Docket Nos. E-04230A-14-0011**

**and E-01933A-14-0011**

**June 16-17, 2014 Hearing**



LAWRENCE V. ROBERTSON, JR.  
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P. O. Box 1448  
Tucson, Arizona 85646

**BEFORE THE ARIZONA CORPORATE**

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**BOB STUMP, Chairman**  
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**BRENDA BURNS**  
**BOB BURNS**  
**SUSAN BITTER SMITH**

ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

ORIGINAL

IN THE MATTER OF REORGANIZATION ) DOCKET NO. E-04230A-14-0011  
OF UNS ENERGY CORPORATION ) DOCKET NO. E-01933A-14-0011  
)  
) NOTICE OF FILING DIRECT  
) TESTIMONY ON BEHALF OF  
) SOUTHERN ARIZONA  
) HOMEBUILDERS ASSOCIATION

Southern Arizona Homebuilders Association ("SAHBA") hereby provides notice of filing of the Prepared Direct Testimony of David Godlewski on behalf of SAHBA in the above-docketed proceedings.

Dated this 29<sup>th</sup> day of April 2014.

Respectfully submitted,

*Lawrence V. Robertson, Jr.*

Lawrence V. Robertson, Jr.  
Attorney for Southern Arizona Homebuilders  
Association

The original and thirteen (13) copies of the foregoing will be filed the 30<sup>th</sup> day of April 2014 with:

Docket Control Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

A copy of the same served by e-mail or first class mail that same date to:

Arizona Corporation Commission

DOCKETED

APR 30 2014

DOCKETED BY

*[Signature]*

- 1 Lyn A. Farmer, Chief Administrative Law Judge  
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- 2 Arizona Corporation Commission  
1200 West Washington Street
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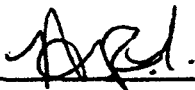
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DIRECT TESTIMONY

OF

DAVID GODLEWSKI

ON BEHALF OF SOUTHERN ARIZONA HOMEBUILDERS ASSOCIATION

DOCKET NO. E-04230A-14-0011

DOCKET NO. E-01933A-14-0011

**Q.1 Please state your name, business affiliation and business address.**

**A.1** My name is David Godlewski. I am President of the Southern Arizona Homebuilders Association ("SAHBA"). My business address and SAHBA's business address is 2840 North Country Club Road, Tucson, Arizona, 85716.

**Q.2 Please describe SAHBA, and include in your description a reference to any instance(s) when SAHBA may have had occasion to participate in proceedings before the Commission on behalf of its members.**

**A.2** SAHBA is a member trade organization with 340 dues-paying members, which includes Home Builders, Developers, and Associate members. SAHBA was incorporated in 1952, and its coverage area from the National Association of Home Builders includes Pima, Cochise and Santa Cruz Counties. SAHBA is a 501(C)(6) organization under the United States Internal Revenue Code.

SAHBA represents building industry professionals ranging from builders, developers, land planners, architects, engineers, environmental consultants, trade contractors, banking and mortgage, real estate, and the many supporting disciplines necessary to create, sell, remodel, furnish and maintain new homes and communities throughout Southern Arizona. SAHBA provides a venue for its members to share information and to network with other professionals involved in the home building industry. SAHBA serves as an advocate for its membership and keeps them apprised of changes in regulatory and governmental matters that will affect their businesses, and

1 participates in regulatory proceedings as appropriate. SAHBA also serves as the  
2 sponsoring organization of a semi-annual home show allowing members and other  
3 merchants to gather and showcase the latest in home improvement and indoor and outdoor  
4 living areas.

5 In connection with the foregoing, SAHBA actively participated as an advocate on  
6 behalf of its membership in the proceedings before the Commission in Docket Nos. E-  
7 01933A-07-0402 and E-01933A-05-0650, which resulted in the Commission's issuance of  
8 Decision No. 72501. That decision reinstated Tucson Electric Power Company's ("TEP")  
9 historic line extension tariff provisions, which previously had been "removed" by TEP  
10 pursuant to the Commission's Decision No. 70628. In addition, SAHBA actively  
11 participated as an advocate on behalf of its membership in the proceedings in Docket No.  
12 W-01933A-12-0291, which was TEP's most recent rate case; and, SAHBA was a signatory  
13 party to the Settlement Agreement reached in that proceeding which was approved by the  
14 Commission in Decision No. 73912.

15  
16 **Q.3 Did you participate on behalf of SAHBA and its members in each of these**  
17 **proceedings?**

18 **A.3 Yes.**  
19

20 **Q.4 Why did SAHBA and its members decide to seek leave to intervene and participate in**  
21 **this proceeding?**

22 **A.4** On January 10, 2014, UNS Energy Corporation ("UNS Energy") and Fortis, inc. ("Fortis")  
23 filed a Joint Notice of Intent to Reorganize with the Commission pursuant to A.A.C. R14-  
24 2-801 et seq. describing a proposed reorganization which would ultimately result in the  
25 merger of UNS Energy and Fortis, if approved by the Commission as requested by UNS  
26 Energy and Fortis. SAHBA's utility regulatory attorney has advised us that the governance  
27 provisions of the merger agreement between UNS Energy and Fortis provide that within  
28 two (2) years following completion of the merger Fortis will occupy a dominant role in

1 determining the composition of the Board(s) of Directors for UNS Energy and its utility  
2 affiliates, TEP, UNS Electric and UNS Gas. As a consequence, Fortis will also be in a  
3 position to substantially influence the policies of UNS Energy and its utility affiliates with  
4 respect to relationships with their respective ratepayers and the communities within which  
5 they provide service.

6 In that regard, both as ratepayers and as residents and businesses within the  
7 communities in which TEP provides electric service, SAHBA and its members have shared  
8 a mutually beneficial relationship with TEP as the local electric service provider. On more  
9 than one (1) occasion, TEP has been both attentive and responsive to the concerns and  
10 needs of SAHBA and its members. Accordingly, it is SAHBA's hope that this positive and  
11 ongoing historic collaborative relationship will be continued into the future, in the event  
12 that the proposed merger is approved by the Commission.

13 Against the above background, SAHBA concluded that its participation in this  
14 proceeding on behalf of both SAHBA and its members was necessary and appropriate.  
15 Clearly, SAHBA and its members could be substantially and directly affected by a  
16 Commission decision approving the proposed merger. Further, there is no other person or  
17 entity best qualified to articulate and advance the particular interests of SAHBA and its  
18 members.

19  
20 **Q.5 Please provide a specific example of how the current policies of TEP are important to**  
21 **SAHBA and its members.**

22 **A.5** As I previously indicated, in its Decision No. 72501, the Commission reinstated TEP's  
23 historic line extension tariff provisions. This reinstatement was, and continues to be,  
24 critical to the economic well-being of the developer and homebuilder industries in TEP's  
25 service area as they endeavor to recover from the devastating effects of the 2008 financial  
26 crisis and the subsequent recession, which particularly impacted their industries. In that  
27 regard, 5,000 annual new housing starts has been considered to be the baseline for a healthy  
28 homebuilding industry in Pima County, yet during 2013 the rate of recovery had

1 progressed to approximately 2,250 new starts.

2 In connection with the foregoing, the ability of the developer and homebuilder  
3 industries to successfully recover and move forward in turn directly impacts the economic  
4 well-being of hundreds of businesses and thousands of jobs in TEP's service area which are  
5 dependent upon these industries.

6 Against this background, any change in TEP's current line extension policies that  
7 conceivably could have a detrimental economic impact upon the developer and  
8 homebuilding industries would be a matter of serious concern to SAHBA and its members.  
9 SAHBA's members already make significant advances in aid of construction and  
10 contributions in aid of construction to fund electric utility infrastructure under TEP's  
11 current line extension policies. Depending upon the circumstances, they may also be  
12 required to pay "carrying costs" and "gross up" amounts to TEP. Further, all of these types  
13 of project expenditures are being made in an environment where, as a result of the post-  
14 2008 recession, sources of financing historically relied upon by the homebuilding industry  
15 are no longer available. In that regard, in recent years, TEP and its senior management  
16 have been aware of and particularly responsive to the needs and concerns of SAHBA and  
17 its members, for which we are most appreciative.

18  
19 **Q.6 How and upon whom would a change in the current line extension policies of TEP**  
20 **have a detrimental economic impact?**

21 **A.6** It is important to understand that developers and homebuilders know as a part of their  
22 planning and entitlement process for residential subdivisions what infrastructure funding  
23 will be required of them. Given that this is a process which can entail many months, and  
24 perhaps several years, it is imperative that they not be subject to sudden or unanticipated  
25 changes in policies and regulations which implicate that planning process, including utility  
26 line extension policies. In that regard, as the housing market begins to recover in southern  
27 Arizona, builders and developers are again buying land to take through the planning and  
28 entitlement process. Needless to say, any abrupt or dramatic change in line extension

1 policies could (i) jeopardize, if not eliminate, the economic feasibility of some projects and  
2 (ii) also adversely impact those businesses and jobs which are dependent upon the  
3 homebuilding industry. Thus, coordination and collaboration among TEP and SAHBA's  
4 members is very important from SAHBA's perspective.

5  
6 **Q.7 Please provide a specific example of how the current relationship between SAHBA,**  
7 **and its members and TEP is mutually beneficial.**

8 **A.7** As I have previously indicated, TEP is a long-standing and valued partner of SAHBA and  
9 its members. In our efforts to advocate for our membership and keep them apprised of  
10 changes in regulatory and governmental matters that will affect their businesses, SAHBA  
11 hosts a monthly Technical Committee Meeting with members of our association and  
12 representatives from government, government agencies and utilities. This venue provides  
13 an opportunity for TEP to share news and information relevant to SAHBA members and  
14 for SAHBA members to engage with TEP on matters of importance to their projects. This  
15 results in ongoing dialogue between TEP and SAHBA members that is beneficial to both.

16  
17 **Q.8 Is it the hope of SAHBA and its members that within the context of this proceeding**  
18 **both UNS Energy and Fortis will indicate an express intent to continue the positive**  
19 **relationship between TEP and the developer and homebuilder business communities**  
20 **within TEP's service area?**

21 **A.8** Absolutely. We would be very surprised and disappointed if that was not the intent of each  
22 company; and, the context of this proceeding provides an appropriate opportunity for them  
23 to express such an intent.

24  
25 **Q.9 At what point(s) in this proceeding might such an expression of intent occur?**

26 **A.9** You have advised me that three (3) opportunities for a written expression of an intent of  
27 that nature by UNS Energy and Fortis would be within (i) the language of the Settlement  
28 Agreement, if a settlement is reached, (ii) the prepared Rebuttal Testimony of UNS Energy



1 and Fortis, if a settlement is not reached, or (iii) as an agreed upon additional written  
2 condition to the merger, supplemental to the twenty-four conditions proposed thus far by  
3 UNS Energy and Fortis, whether or not a Settlement Agreement is reached.  
4

5 **Q.10 In their January 24, 2014 prepared Direct Testimony, UNS Energy's and Fortis'**  
6 **witnesses discussed the governance provisions of their Merger Agreement, and how**  
7 **the same could affect the size and composition of the Board of Directors of both UNS**  
8 **Energy and TEP upon completion of the merger and in subsequent years. Is the size**  
9 **and composition of those Boards of Directors a matter of interest to SAHBA and its**  
10 **members; and, if so, why?**

11 **A.10 Yes, SAHBA is quite interested in both the size and composition of each Board of**  
12 **Directors which you have mentioned. Those Boards of Directors will (i) set policy for**  
13 **UNS Energy and TEP as to a wide array of matters and/or (ii) make policy**  
14 **recommendations to Fortis U.S. and Fortis with respect to the operations of those two (2)**  
15 **companies.**

16 In that regard, SAHBA believes that each of those Boards of Directors should be  
17 large enough to allow for a diverse mixture of backgrounds and experience among the  
18 Board membership as a whole. In addition, SAHBA believes that the preponderance of  
19 members of TEP's Board of Directors should reside and (preferably) do business or have  
20 business relationships in TEP's service area.  
21

22 **Q.11 Do SAHBA and its members believe that, in determining whether or not the proposed**  
23 **merger would be in the "public interest," the Commission should take into account**  
24 **the views of Fortis as to what will be the size and composition of future Boards of**  
25 **Directors for UNS Energy and TEP?**

26 **A.11 In terms of the two (2) general guidelines or criteria I have suggested, yes. And, I would**  
27 **think criteria of that nature would probably also be appropriate for consideration with**  
28 **respect to the Boards of Directors of UNS Electric and UNS Gas, given the goal of Board**

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1 membership which is both diverse and attuned to the particular needs and characteristics of  
2 the service area(s) in question.

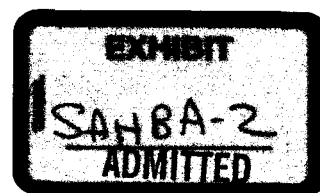
3  
4 **Q.12 Does SAHBA have a position with respect to the proposed merger between UNS**  
5 **Energy and Fortis?**

6 **A.12 Not as of this juncture.**

7  
8 **Q.13 Does that complete your Direct Testimony on behalf of SAHBA and its members?**

9 **A.13 Yes.**

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28



# **Exhibit – SAHBA 2**

**June 2, 2014 Testimony Relating to  
Settlement Agreement of  
David Godlewski**

**UNS Energy and Fortis, Inc.  
Docket Nos. E-04230A-14-0011  
and E-01933A-14-0011  
June 16-17, 2014 Hearing**

LAWRENCE V. ROBERTSON, JR.  
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Tucson, Arizona 85646

**BEFORE THE ARIZONA CORPORATION**

**COMMISSIONERS**

**BOB STUMP, Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH**

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**ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL**

**IN THE MATTER OF REORGANIZATION ) DOCKET NO. E-04230A-14-0011  
OF UNS ENERGY CORPORATION ) DOCKET NO. E-01933A-14-0011  
)  
) **NOTICE OF FILING TESTIMONY OF**  
) **DAVID GODLEWSKI ON BEHALF OF**  
) **SOUTHERN ARIZONA**  
) **HOMEBUILDERS ASSOCIATION IN**  
) **SUPPORT OF PROPOSED**  
) **SETTLEMENT AGREEMENT****

Southern Arizona Homebuilders Association ("SAHBA") hereby provides notice of filing of the Testimony of David Godlewski on behalf of SAHBA In Support of Proposed Settlement Agreement in the above-docketed proceedings.

Dated this 2<sup>nd</sup> day of June 2014.

Respectfully submitted,

*Lawrence V. Robertson, Jr.*

Lawrence V. Robertson, Jr.  
Attorney for Southern Arizona Homebuilders  
Association

The original and thirteen (13) copies of the foregoing will be filed the 2<sup>nd</sup> day of June 2014 with:

Docket Control Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Arizona Corporation Commission

**DOCKETED**

**JUN 02 2014**

DOCKETED BY

*SAH*

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1 A copy of the same served by e-mail  
or first class mail that same date to:

2 Lyn A. Farmer, Chief Administrative Law Judge  
3 Hearing Division  
4 Arizona Corporation Commission  
5 1200 West Washington Street  
Phoenix, Arizona 85007

6 Jane L. Rodda, Administrative Law Judge  
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8 Arizona Corporation Commission  
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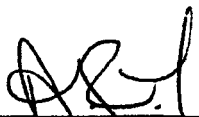
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TESTIMONY OF DAVID GODLEWSKI  
ON BEHALF OF SOUTHERN ARIZONA HOMEBUILDERS ASSOCIATION  
IN SUPPORT OF  
UNS ENERGY/FORTIS MERGER  
PROPOSED SETTLEMENT AGREEMENT  
DOCKET NO. E-04230A-14-0011  
DOCKET NO. E-01933A-14-0011

Q.1 Please state your name, business affiliation and business address.

A.1 My name is David Godlewski. I am President of the Southern Arizona Homebuilders Association ("SAHBA"). My business address is 2840 North Country Club Road, Tucson, Arizona, 85716.

Q.2 Are you the same David Godlewski whose prepared Direct Testimony was filed in this proceeding with the Commission's Docket Control on April 30, 2014?

A.2 Yes, I am.

Q.3 What is the purpose of the testimony you are submitting at this time?

A.3 I am testifying on behalf of SAHBA and its members in support of the Settlement Agreement and related Settlement Conditions in this proceeding. That Settlement Agreement and the related Settlement Conditions were filed with the Commission's Docket Control on May 16, 2014; and, SAHBA is a signatory party to the Settlement Agreement.

Q.4 Did SAHBA participate in the negotiations and subsequent drafting which resulted in the Settlement Agreement?

A.4 Yes. I was in attendance throughout the settlement negotiations that were conducted in the Commissioners' Conference Room at the Commission's Offices in Phoenix on May 5, 2014. Thereafter, SAHBA's attorney of record in this proceeding and I reviewed the draft

1 language of the Settlement Agreement and related Settlement Conditions, as circulated by  
2 the Commission's Staff, and we offered such comment as we deemed necessary or  
3 appropriate from SAHBA's perspective. Finally, once the language of the Settlement  
4 Agreement and related Settlement Conditions had been agreed upon by all the parties who  
5 intended to become signatories, I executed the Settlement Agreement upon behalf of  
6 SAHBA.

7  
8 **Q.5 Why did SAHBA and its members decide to sign and support the Settlement**  
9 **Agreement and related Settlement Conditions?**

10 **A.5** The reasons are both general in nature, and specific to the interests of SAHBA and its  
11 members.

12 From a general perspective, the Settlement Agreement and related Settlement  
13 Conditions reflect the results of good faith and arms-length negotiations among most of the  
14 parties to this proceeding and a balancing of interests. In that regard, Sections 1.7 and 5.1  
15 of the Settlement Agreement state

16 "The terms of this Agreement are just, reasonable, fair, and in the  
17 public interest in that they provide a just and reasonable resolution  
18 of the issues arising from this Docket and, among other things,  
19 establish appropriate conditions to ensure quality of service by the  
20 Regulated Utilities, enhance the financial strength of UNS Energy  
21 and the Regulated Utilities, retain local control of the Regulated  
22 Utilities, improve access to capital for UNS Energy and the  
23 Regulated Utilities, and avoid unnecessary litigation expense and  
24 delay."

25 and

26 "This case has attracted a large number of participants with widely  
27 diverse interests. To achieve consensus for settlement, many  
28 participants are accepting positions that, in any other  
circumstances, they would be unwilling to accept. They are doing  
so because this Agreement, as a whole, is consistent with their  
long-term interests and with the broad public interest. The  
acceptance by any Signatory of a specific element of this  
Agreement shall not be considered as precedent for acceptance of  
that element in any other context."



1 In addition, from the perspective of the specific interests of SAHBA and its  
2 members, the Settlement Agreement and certain of the related Settlement Conditions  
3 satisfactorily address several interests and concerns that I discussed in my previously filed  
4 prepared Direct Testimony in this proceeding. The remainder of the Settlement Conditions  
5 are either consistent with or not relevant to the interests of SAHBA and its members.

6  
7 **Q.6 Please identify those specific interests and concerns, and discuss the Settlement**  
8 **Conditions which satisfactorily address the same.**

9 **A.6** One area of interest for SAHBA and its members pertains to Tucson Electric Power  
10 Company's ("TEP") current line extension policies. As I indicated in my prepared Direct  
11 Testimony, a material change in those policies conceivably could have a detrimental  
12 economic impact upon the developer and homebuilder industries in TEP's service area, as  
13 well as those other businesses and employers whose economic well-being is dependent  
14 upon or influenced by those two industries. Settlement Condition No. 32 is a recognition  
15 of and makes specific provision for this interest of SAHBA and its members, and states as  
16 follows:

17 "TEP will not propose any material modifications to its existing  
18 Line Extension tariff in its next rate case and TEP will abide by the  
19 Line Extension tariff as approved by, or may be approved by, the  
Commission."

20 As may be noted, this language provides in effect that SAHBA and its members will have  
21 (i) advance notice of any material change in its current line extension policies which TEP  
22 might wish to propose at some future date, and (ii) an opportunity to express such position  
23 as SAHBA might have with respect to such proposed material change in a formal  
24 proceeding before the Commission before such a change could become effective. In that  
25 regard, given the historic collaborative relationship which has existed between TEP and  
26 SAHBA and its members, SAHBA anticipates that TEP would engage in a constructive  
27 dialogue with SAHBA before reaching a decision as to whether or not to propose a material  
28 change.

1 A second area of interest to SAHBA and its members related to the future size and  
2 composition of the Board(s) of Directors of TEP and UNS Electric. As I indicated in my  
3 previously filed prepared Direct Testimony, SAHBA and its members believe that the size  
4 and composition of future Board(s) of Directors of those two (2) entities should be such as  
5 to (i) allow for a diverse mixture of background and experience among the Board members  
6 as a whole, and (ii) provide that Board members will be personally familiar with the  
7 business conditions and relationships of the service area in question. In that regard,  
8 Settlement Condition No. 37 provides as follows:

9 "Fortis shall have appointed the Board of Directors of UNS Energy  
10 which shall have oversight over UNS Energy and the Regulated  
11 Utilities no later than one year after the closing. A majority of the  
12 directors of UNS Energy shall have and shall have had permanent  
13 residence in Arizona for at least 3 years prior to appointment. A  
14 majority of directors of UNS Energy shall be independent."

15 Based upon information acquired from representatives of Fortis and UNS Energy during  
16 the settlement negotiations as to how Fortis intends to determine the size and composition  
17 of future Board(s) of Directors of UNS Energy and the Arizona Utilities, given Fortis'  
18 future role as the sole shareholder of UNS Energy, SAHBA and its members believe that  
19 Settlement Condition No. 37 satisfactorily addresses the subject of Board of Director size  
20 and composition.

21 A third area of interest to SAHBA and its members was continuation of the ongoing  
22 positive and collaborative relationship which has existed for a number of years between  
23 TEP and SAHBA and its membership. Based upon statements made by Fortis and UNS  
24 Energy's representatives during the settlement negotiations, and given the aforementioned  
25 responsiveness of Settlement Condition Nos. 32 and 37 to other areas of interest to SAHBA  
26 and its members, we believe that Fortis and UNS Energy intend to both continue and build  
27 upon that historic relationship. Further illustrative of that intent is the language of  
28 Settlement Condition No. 41(iii), which provides that UNS Energy and its subsidiaries  
"shall continue to support, and where appropriate, enhance (a) existing . . . economic . . .  
partnerships and (c) consumer partnerships." Needless to say, against this background, we

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1 would be very surprised and disappointed if in fact our anticipation did not prove to be the  
2 case.

3  
4 **Q.7 Does SAHBA's execution of and support for the Settlement Agreement and related**  
5 **Settlement Conditions mean that SAHBA would have no objection to a Commission**  
6 **decision approving the proposed merger?**

7 **A.7** Yes, provided that a final Commission decision did not alter the Settlement Agreement and  
8 related Settlement Conditions in such a manner as to be detrimental to the interests of  
9 SAHBA and its members.

10  
11 **Q.8 Does that conclude your testimony in support of the Settlement Agreement and**  
12 **related Settlement Conditions?**

13 **A.8** Yes, it does.  
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**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS**

BOB STUMP, Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH

IN THE MATTER OF THE REORGANIZATION  
OF UNS ENERGY CORPORATION.

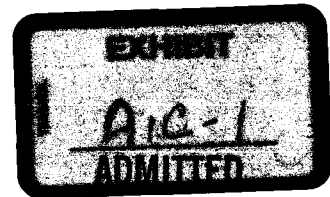
Docket Nos. E-04230A-14-0011  
E-01933A-14-0011

**Direct Testimony**  
  
**of Gary Yaquinto**

**on Behalf of**

**Arizona Investment Council**

**April 30, 2014**



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## I. QUALIFICATIONS

**Q. Please state your name, position and business address.**

**A.** Gary M. Yaquinto. I am President and CEO of the Arizona Investment Council ("AIC").  
Our offices are located at 2100 North Central Avenue, Phoenix, Arizona 85004.

**Q. Please summarize your educational background and professional experience.**

**A.** I earned B.S. and M.S. Degrees in Economics in 1974 from Arizona State University, as well as an MBA from the University of Phoenix in 2005. From 1975 to 1977, I was employed by the State of Wyoming as an economist responsible for evaluating the economic, fiscal and demographic effects of resource development in Wyoming. From 1977 to 1980, I served as Chief Research Economist for the Arizona House of Representatives and from 1980 to 1984 was employed as an economist in the consulting industry. Since 1984, I have worked in various capacities in government and the private sector in the area of utility regulation, including positions with the Commission's Utilities Division Staff, a competitive local exchange telephone carrier and as a consultant. I also served as the Chief Economist at the Arizona Attorney General's Office from 2003-2005 and was the Director of the Governor's Office of Strategic Planning and Budgeting from 2005-2006. I became AIC's President in December of 2006.

## II. ARIZONA INVESTMENT COUNCIL ("AIC")

**Q. What is the Arizona Investment Council and what is its mission?**

A. The AIC is a non-profit association organized under Chapter 501(c)(6) of the Internal Revenue Code. AIC's membership includes several Arizona utilities, as well as approximately 6,000 individuals—many of whom are debt and equity investors in Arizona utilities and other Arizona businesses.

AIC's mission is to advocate on behalf of its members' interests, primarily before regulatory bodies as well as the Legislature and, specifically, to enlarge and maximize the influence of utility investors on public policies and governmental actions that impact investors and their investments.

AIC also works with the Commission and policymakers generally to find ways to support investment in Arizona's essential backbone infrastructure, as well as improvements to, or remediation of, existing facilities. We view this aspect of our mission as complementary to our core advocacy of investor interests.

## III. TESTIMONY

**Q. What is the purpose of your testimony?**

A. The purpose of my testimony is to support the proposed acquisition of UNS Energy by Fortis, Inc. The transaction will strengthen UNS Energy and its Arizona Utilities (Tucson Electric Power, UNS Electric and UNS Gas), leading to improved credit ratings and a lower cost of capital. Among other things, Fortis' injection of \$200 million of

1 capital will strengthen UNS' balance sheet, providing funds for TEP's and UNS  
2 Electric's diversification of their generation portfolios. The merger with a financially  
3 strong Fortis will also facilitate access to capital markets on more favorable rates, terms  
4 and conditions.

5  
6 **Q. How will the Fortis Acquisition strengthen the financial positions of UNS Energy**  
7 **and the Arizona Utilities?**

8 A. As company witnesses Bonavia and Hutchens point out, UNS Energy anticipates needing  
9 \$2 billion for new capital investments over the next five years to serve customers of the  
10 Arizona Utilities. About one-half of that is aimed at projects in the next two years.  
11 Obviously, that requires access to debt and equity financing.

12  
13 Fortis has agreed to infuse \$200 million of equity capital (10 percent of this total need)  
14 into UNS Energy upon completion of the transaction. From the testimony of UNS  
15 witness Larson, "UNS Energy will either invest the \$200 million as equity into TEP and  
16 UNS Electric, retire UNS Energy shorter-term debt, or some combination of the equity  
17 contribution and debt retirement" (Kevin Larson Direct Testimony, p. 4, ll. 22-24).  
18 Obviously, that will deliver a more balanced consolidated capital structure and will  
19 improve UNS' percentage of common equity-to-debt from 42.6 percent to 44.1 percent.

20  
21 Further, the \$200 million Fortis equity infusion will be a major component of the  
22 financing needed to complete the purchase of the Gila River Power Plant ("GRPP")  
23 Unit 3 by TEP and UNS Electric. This gas-fired Unit 3 acquisition is critical to TEP's



1 and UNS Electric's plans to serve customers reliably and cost effectively in the face of  
2 increasingly stringent environmental regulations on coal-fired assets.

3  
4 **Q. Is the proposed transaction likely to improve the credit ratings of UNS Energy and**  
5 **the Arizona Utilities?**

6 A. Yes. Two of the three major credit rating agencies issued positive outlooks after the  
7 announcement of the transaction.

8  
9 Fitch placed the TEP ratings watch on "positive" following announcement of the merger.  
10 Fitch referenced improved access to capital based on Fortis' financial strength and the  
11 \$200 million equity infusion as two of the reasons for the positive outlook (Fitch Ratings,  
12 "Fitch Places Tucson Electric Power Co.'s Ratings on Rating Watch Positive on Merger  
13 Announcement," December 13, 2013).

14  
15 Similarly, Standard & Poor's Ratings Services raised TEP to "positive" from "stable,"  
16 further indicating a credit upgrade is possible if the merger does not add debt to TEP or  
17 UNS Energy (Standard & Poor's Ratings Services, *Ratings Direct*, December 13, 2013).

18  
19 Finally, Moody's Investor's Service stated: "Fortis' potential ownership to be credit  
20 neutral to slightly positive for UNS as the utility would have access to Fortis' larger scale  
21 and scope which may help with the funding of capital expenditures, reduce certain  
22 operating costs and provide access to the capital markets" (Moody's Investor Service,  
23 December 12, 2013).

1 **Q. Earlier in your testimony, you stressed the importance of Fortis' infusion of**  
2 **\$200 million equity capital into UNS Energy. Please expand on that point.**

3 A. TEP's current generation portfolio is heavily weighted toward coal-fired generation. In  
4 fact, 80 percent of TEP's load is met by coal assets. While those assets have served  
5 TEP's customers with reliable and affordable electricity, compliance with recent and  
6 future environmental regulations will require investments in costly emissions technology  
7 on aging coal facilities that might be nearing the end of their useful lives. Consequently,  
8 TEP and utilities nationwide are evaluating alternatives to meet load requirements,  
9 including replacing older coal assets with cleaner technologies, including combined cycle  
10 natural gas plants like GRPP. Further, the closure of two units at San Juan in New  
11 Mexico by 2017, coupled with TEP's decision to reduce its reliance on coal-fired  
12 Springerville Unit 1, requires TEP to acquire new resources to fill that supply gap.

13  
14 The cost of acquiring GRPP Unit 3 is estimated at \$219 million. Obviously, Fortis'  
15 commitment to infuse \$200 million is coming at a very critical time for the Companies.  
16 In this regard, I also note that TEP's 2014 Integrated Resource Plan (filed with the  
17 Commission on April 1, 2014) lays out the company's plan for reducing its dependence  
18 on coal generation from the current 80 percent to 57 percent by 2020.

19  
20 **Q. In what other ways is the proposed transaction positive for the customers,**  
21 **employees and communities served by the Arizona Utilities?**

22 A. Fortis is Canada's largest investor-owned utility company and has a proven success  
23 record not only in Canada but, as well, New York State and the Caribbean. Fortis'

1 standard practice allows its subsidiaries to be managed locally on a stand-alone basis.

2 Thus, local utilities maintain all characteristics of a "home-based" utility, including  
3 customer care relationships, connection with community and civic activities and ongoing  
4 relationships with its workforce.

5  
6 Specifically, Mr. Hutchens summarizes Fortis' commitments in these areas, including:

- 7 - Support of existing levels of charitable and community contributions;
- 8 - Maintenance of existing low-income programs;
- 9 - Maintenance of existing employment and employee benefits for at least two  
10 years; and
- 11 - Honoring existing collective bargaining agreements.

12  
13 **Q. Are UNS Energy and Fortis proposing conditions to address potential financial**  
14 **concerns about the acquisition from the standpoint of the Arizona Utilities?**

15 **A.** Yes. UNS and Fortis have agreed to several measures to ensure that the Arizona Utilities  
16 are shielded from risks associated with Fortis' other operations and to ensure that the  
17 Arizona Utilities' customers continue to receive high quality, safe and reliable service at  
18 reasonable prices.

19  
20 These conditions are fully explained in the testimonies of Messrs. Hutchens (Direct,  
21 pp. 8-14) and Larson (Direct, pp. 10-11). Of particular note are the financial protections  
22 outlined by Mr. Larson. These include an agreement that the Arizona Utilities will not  
23

1 financially support Fortis or its affiliates absent ACC authorization; and a stipulation that

2 Fortis cannot have cross default provisions that implicate or affect the Arizona Utilities.

3  
4 **Q. Mr. Yaquinto, your testimony so far has addressed the proposed merger from the**  
5 **perspective of the Arizona Utilities and their customers. How do you view Fortis'**  
6 **position in the transaction?**

7 A. I found very interesting Fortis' CEO H. Stanley Marshall's comments that, because his  
8 company expects Arizona's economy to outperform other U.S. states, that "will provide  
9 Fortis with opportunities for capital investment to meet the future needs of the Arizona  
10 Utilities' customers."<sup>1</sup> So, somewhat uniquely, the strength of this Fortis acquisition lies  
11 not only in its current benefits and capital infusions, but also in the fact Fortis sees it as  
12 an ongoing investment opportunity.

13  
14 **Q. You mentioned geographic diversity earlier. Please elaborate.**

15 A. Fortis has regulated electric and gas operations in five Canadian provinces, the State of  
16 New York and two Caribbean countries, together with non-regulated generation and  
17 commercial real estate/hotel operations. Fortis' regulated utilities account for  
18 approximately 90 percent of its total assets. Adding the Arizona Utilities' operations in  
19 our southwestern U.S. state further enhances the stability and diversity of all of the  
20 organization's component parts. Slowdowns or negative economic trends in some areas  
21 or economic sectors are likely to be offset by positives and gains in operations and areas  
22 elsewhere. Further, from a credit ratings standpoint, all but one of the utilities in the

23 <sup>1</sup> Marshall Direct, p. 10.

1 Fortis' group has ratings that are superior to the UNS Energy, TEP and UNS Electric and  
2 Gas ratings. The combination of the two organizations will redound to Arizona's benefit  
3 and, correspondingly, further strengthen Fortis' profile.  
4

5 **Q. Are there other aspects of Fortis' operation which you'd stress?**

6 A. I was particularly impressed by CFO Barry Perry's discussion of Fortis' financial  
7 strength, equity issuances and liquidity at pages 6-7 of his Direct Testimony. Most  
8 remarkable was the fact that, notwithstanding the exceptionally challenging credit crisis  
9 of 2008, Fortis raised nearly C\$1.2 billion in capital markets that year.  
10

11 Although Fortis makes clear that each utility—including the Arizona Utilities—is  
12 financed on a stand-alone basis, Fortis' experience and strengths in these areas will  
13 undoubtedly benefit the Arizona Utilities and their customers. Additionally, the proposed  
14 protections concerning legal separateness and elimination of potential cross defaults on  
15 parent and subsidiary financial transactions, as discussed previously, provide a measure  
16 of financial insulation for the Arizona Utilities.  
17

18 **Q. Mr. Yaquinto, in his testimony, Mr. Hutchens recommends that the Commission**  
19 **modify the original 1997 UNS Holding Company Order and basically substitute**  
20 **certain provisions of the Order which issues in this proceeding for that Decision.**  
21 **Does AIC have a position on that recommendation?**

22 A. While I'd stress that I'm not intimately familiar with the 1997 Decision, the  
23 recommendation certainly seems to make a lot of sense. Almost two decades have  
24

1 elapsed since its issuance. The recommendation to replace it with appropriate conditions  
2 structured in the current case certainly seems like a very rational and cohesive way to  
3 proceed.

4  
5 **Q. Do you have a recommendation for the Commission?**

6 **A.** Yes. I recommend the Commission approve the proposed merger.

7  
8 **Q. Does this conclude your testimony?**

9 **A.** Yes, it does.

10

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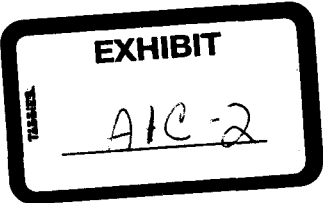
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**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS**

**BOB STUMP, Chairman**  
**GARY PIERCE**  
**BRENDA BURNS**  
**BOB BURNS**  
**SUSAN BITTER SMITH**



**IN THE MATTER OF THE REORGANIZATION  
OF UNS ENERGY CORPORATION.**

Docket Nos. E-04230A-14-0011  
E-01933A-14-0011

**Settlement Agreement Testimony**

**of Gary Yaquinto**

**on Behalf of**

**Arizona Investment Council**

**June 2, 2014**

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**I. INTRODUCTION**

**Q. Please state your name, position and business address.**

A. Gary M. Yaquinto. I am the President and CEO of the Arizona Investment Council ("AIC"). Our offices are located at 2100 North Central Avenue, Phoenix, Arizona 85004.

**Q. Please restate for the Commission the Arizona Investment Council's interest in this docket.**

A. UNS Energy and its Regulated Utilities must be positioned to attract capital on reasonable terms so that it can provide safe, reliable and adequate utility service to customers while also maintaining financial integrity. As the company indicated in its Direct Testimony filed with the Commission on January 10, 2014, UNS Energy anticipates needing \$2 billion for new capital investments over the next five years. Its acquisition by Fortis, Canada's largest investor-owned utility, with its strong financial metrics combined with Fortis' commitment to infuse \$220 million of equity capital into UNS Energy as agreed to in the Settlement Agreement provides UNS Energy and the Regulated Utilities with an improved financial base upon which to make these investments.

**Q. Have you previously filed testimony in this docket?**

A. Yes. My Direct Testimony was filed on April 30, 2014.

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## II. TESTIMONY PURPOSE

12 Q. What is the purpose of your testimony today?

13 The purpose of my testimony today is to support the Settlement Agreement reached  
14 among the parties.  
15

16 Q. Is AIC a signatory to the Settlement Agreement dated May 16, 2014 (the  
17 "Settlement Agreement")?

18 A. Yes. We participated with the other signatories in the discussions and negotiations which  
19 led to the execution of the Settlement Agreement.  
20

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23  
24

## III. THE SETTLEMENT AGREEMENT

12 Q. Mr. Yaquinto, from AIC's perspective, please outline the Settlement Agreement's  
13 most positive aspects.

14 A. First, the Settlement Agreement commits Fortis' infusion of \$220 million of equity  
15 capital through UNS Energy into the Regulated Utilities. That new capital will comprise  
16 a major part, for example, of the financing needed to complete the purchase of the Gila  
17 River Power Plant Unit 3 by TEP and UNS Electric. However, if the merger transaction  
18 closes after September 30, 2014, the equity infusion may be made into UNS Energy for  
19 the purpose of retiring of debt which, of course, strengthens its balance sheet. This equity  
20 infusion is \$20 million more than originally proposed by Fortis. It will further improve  
21 the financial and credit metrics of UNS Energy and its Regulated Utilities.  
22  
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24

1 Second, as I indicated in my Direct Testimony, two of three major credit rating agencies  
2 issued positive outlooks following the announcement of the transaction. The analysts  
3 referenced improved access to capital by UNS and its Regulated Utilities resulting from  
4 the merger. The Settlement Agreement will further strengthen this positive assessment.

5  
6 Third, the Settlement Agreement reinforces Fortis' commitment to continued local  
7 management, control and security of operations of the UNS Regulated Utilities.  
8 Experienced management familiar and in-tune with managing utilities within Arizona's  
9 regulatory and community environments benefits investor and customer interests alike.  
10 Relevant conditions are set forth in Section E, "Corporate Governance" and include,  
11 among others:

- 12 - Establishing a "golden share" to be held by an individual residing in Arizona  
13 whose consent is needed for UNS Energy to file for voluntary bankruptcy  
14 protection (Condition 38);
- 15 - A majority of directors appointed to the UNS Board must be permanent residents  
16 in Arizona for at least 3 years prior to appointment and be independent  
17 (Condition 37);
- 18 - The UNS Energy corporate headquarters will remain in Tucson (Condition 40);
- 19 - The Regulated Utilities' Board will be responsible for management and oversight  
20 generally, including approval of annual capital and operating budgets  
21 (Condition 41.i);

- Local management will continue to make decisions regarding staffing levels, negotiate collective bargaining agreements and represent the Regulated Utilities in future regulatory matters (Condition 41.ii); and
- UNS Energy and its subsidiaries will continue their support of charitable and community-related programs (Condition 41.iii).

These provisions are very consistent with Fortis' overall approach of utility ownership – allowing its local utility subsidiaries to manage operations without interference from the holding company. This is the same model currently in place and operating well for Fortis' utility holdings in Canada, New York and the Caribbean islands.

Finally, the Settlement Agreement provides appropriate ring-fencing mechanisms to protect the Regulated Utilities and their customers from financial problems that might arise elsewhere in Fortis holdings. These mechanisms are specified in Section B, "Credit Quality and Capital Requirements" and include:

- Restrictions on up-streaming dividends from the Regulated Utilities (Condition 16);
- UNS Energy to maintain a capital structure separate from Fortis (Condition 17);
- UNS Energy and its Regulated Utilities will not pledge or encumber assets for the benefit of Fortis or its other affiliates and won't guarantee any indebtedness of Fortis (Condition 18);

- The Regulated Utilities will maintain banking committed credit facilities and cash management arrangements that are separate from UNS Energy, FortisUS, Fortis and other affiliates (Condition 24); and
- There is also a prohibition of any cross default provisions that affect the Regulated Utilities (Condition 25).

**Q. Mr. Yaquinto, do you have any other comments on the Settlement Agreement's provisions?**

A. Yes. Condition 31 requires TEP and UNS Electric to propose a pilot program for a "buy through" tariff available to Large Light and Power Service and Large Power Service customers. While AIC supports the Settlement Agreement, including this requirement that such a tariff be proposed as a pilot program by TEP and UNS electric in their next rate case filings, we will take a close look at the details of this pilot proposal and state any concerns should it appear investors could be adversely affected.

**Q. Do you have any additional comments to make?**

A. Yes. With few exceptions, credit and equity analysts have recognized and commented on the improved regulatory climate at the ACC. This is due, in part, to shorter case processing times for major cases and the Commission's willingness to consider Settlement Agreements reached among parties. The Commission's actions to reduce regulatory lag and improve certainty in processing cases has contributed greatly to improved debt and equity ratings of many of Arizona's utilities. That, of course, has the very positive impacts for utility customers as well.

1       These efforts in this matter, including the relatively rapid pace outlined for reaching a  
2       decision in this case, have continued this very positive course.

3  
4   **Q.    Do you have a recommendation for the Commission?**

5   A.    Yes. I recommend the Commission approve the proposed Settlement Agreement.

6  
7   **Q.    Does this conclude your testimony?**

8   A.    Yes, it does.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP- CHAIRMAN

GARY PIERCE

BRENDA BURNS

SUSAN BITTER SMITH

BOB BURNS

EXHIBIT

ACAA-1

IN THE MATTER OF REORGANIZATION ) DOCKET No. E-04230A-14-0011  
OF UNS ENERGY CORPORATION ) E-01933A-14-0011  
\_\_\_\_\_ )

Direct Testimony Of

Cynthia Zwick

For

Arizona Community Action Association

April 30, 2014

1 Q. Please state your name, professional title, and your workplace address.

2 A. My name is Cynthia Zwick, I serve as Executive Director of Arizona Community

3 Action Association, which is located at 2700 N 3<sup>rd</sup> St Ste. 3040, Phoenix, AZ

4 85004.

5

6 Q. What is the mission of Arizona Community Action Association?

7 A. Arizona Community Action Association (ACAA) strives to unite communities to

8 end poverty through community-based solutions and initiatives. In the pursuit of

9 these goals, ACAA advocates on behalf of low-income Arizonans in energy and

10 utility issues.

11

12 Q. What is the purpose of your testimony?

13 A. The purpose of my testimony is to explore and explicate Stipulation 24 of the

14 proposed agreement, the "commit[ment] to continue support for the Arizona

15 Utilities' low income assistance programs at or above current levels."

16

17 Q. What is your experience with low-income issues and with rate proceedings in

18 Arizona?

19 A. I have served as a low-income advocate in Arizona since 2003, and have

20 participated in rate cases since that time in order to ensure that the interests and

21 impact of rate increases on the low-income community are heard and understood,

22 and that there is a better understanding of the condition of poverty in Arizona and

23 its impact on utility customers.

24

25 Q. What is the current state of poverty in Arizona today?

26

27 A. Let me start by stating that I absolutely support a healthy electric utility and

28



1 believe that rates that are reasonable and affordable for all customers, including  
2 low-income customers, is not only in the customers' best interest, but also in the  
3 Company's best interest.

4 In 2012, the US Census bureau reported that the Pima County poverty rate  
5 was 20%. The poverty rate for Mohave County was 21.7%. The state of Arizona'  
6 poverty rate was slightly less, at 18.7%.<sup>1</sup> Looking more deeply into the data,  
7 26.7% of Tucson residents live at 100% of the federal poverty level, and in South  
8 Tucson, the number jumps to 52.1%.<sup>2</sup> Arizona currently has the 5<sup>th</sup> highest  
9 poverty rate overall<sup>3</sup> and the 7<sup>th</sup> highest poverty rate for children.<sup>4</sup>  
10  
11

12 The annual income for an individual living at 100% of the federal poverty  
13 level is \$11,670. For a family of four, that annual income is \$23,850. An  
14 individual living at 150% of the federal poverty level earns \$17,505 annually and a  
15 family of four, \$35,775.<sup>5</sup>  
16

17 In March 2014, the Arizona unemployment rate was 7.3 %, down from the  
18 March 2013 rate of 8.0% but still high. The highest level Arizona saw was in  
19 2010, when unemployment reached 10.4%.<sup>6</sup> The Bureau of Labor Statistics  
20 announced in August 2012, that in January 2012, 56% of the 6.1 million long-  
21 tenured displaced workers were re-employed (long-tenured are employees who  
22  
23  
24

25 <sup>1</sup> U.S. Census Bureau, 2012 American Community Survey

26 <sup>2</sup> Ibid

27 <sup>3</sup> "Arizona has 5<sup>th</sup> Highest Poverty Rate." Arizona Indicators, Morrison Institute for Public Policy.

28 <sup>4</sup> Arizona: Demographics, Poverty, and Food Insecurity. <http://frac.org/wp-content/uploads/2010/07/az.pdf>

<sup>5</sup> 2014 Poverty Guidelines, U.S. Department of Health & Human Services

<sup>6</sup> [www.deptofnumbers.com/unemployment/arizona/](http://www.deptofnumbers.com/unemployment/arizona/)

1 have worked for their employers three or more years).<sup>7</sup> Among those long-tenured  
2 workers who were displaced from full-time wage and salary jobs and who were re-  
3 employed in such jobs in January 2012, only 46 % of the re-employed 56% had  
4 earnings that were as much or greater than those of their lost job. So  
5 unemployment remains high, and those re-employed are not making as much as  
6 they were before the recession and the various job losses.  
7

8 Hunger also continues to challenge families in Arizona, children in  
9 particular -- 25% are hungry. Approximately 1 in 5 Arizonans (20.9%), have  
10 experienced times in the past twelve months when they did not have enough  
11 money to buy food that they or their families needed.<sup>8</sup> Arizona ranked 14<sup>th</sup>  
12 nationally for the number of families facing food hardship. SNAP (formerly  
13 known as food stamps) enrollment has also continued to climb in Arizona where  
14 now 1.1 million Arizonans need SNAP to feed themselves and their children, an  
15 increase of 79.2% over the past five years.<sup>9</sup>  
16  
17

18 Q. Are there other factors that need to be taken into consideration when considering  
19 the reorganization of UNS Energy?  
20

21 A. Yes, there are. Additional factors to consider include the very real health risks  
22 associated with an inability to maintain electric service. In a report by the Arizona  
23 Department of Health Services<sup>10</sup>, lack of air conditioning can be a life threatening  
24

25 <sup>7</sup> [www.bls.gov/news.release/disp.nr0.htm](http://www.bls.gov/news.release/disp.nr0.htm)

26 <sup>8</sup> Food Research and Action Center (FRAC), Food Hardship in America 2012.

[http://frac.org/pdf/food\\_hardship\\_2012.pdf](http://frac.org/pdf/food_hardship_2012.pdf)

27 <sup>9</sup> Supra at 4.

<sup>10</sup> Arizona Department of Health Services, Deaths From Exposure to Excessive Natural Heat Occurring in Arizona

1 condition in Arizona. Between 1992 and 2009, 173 Arizona residents died from  
2 exposure to heat while indoors, two-thirds of whom were 65 or older. A recent  
3 report from Maricopa County found that 108 heat deaths occurred in 2012, and of  
4 those more than half occurred at a private residence and 45 happened indoors.<sup>11</sup>

5  
6 The AARP study, "Affordable Home Energy and Health: Making the  
7 Connections,"<sup>12</sup> finds that "Health is at risk *directly* through exposure when heat  
8 is turned down in winter or air-conditioning is turned off in summer, when unsafe  
9 means are used to heat or light homes, and when utility service is lost due to  
10 nonpayment."  
11

- 12 • In response to high home energy prices perceived as unaffordable, 46%  
13 report closing off part of their home for at least one month a year, 24%  
14 maintain their home at what they perceived as an unsafe or unhealthy  
15 temperature and 17% report leaving their home for part of the day because  
16 they were unable to maintain moderate indoor temperatures.  
17
- 18 • More than one-quarter (27%) report using the kitchen stove or oven for  
19 heat, and 4% use candles or lanterns because of loss of utility service for  
20 non-payment.  
21
- 22 • More than one-quarter (28%) report skipping payments of a utility bill or  
23 paying less than the full amount, 19% received a shut-off notice within the  
24

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25 1992-2009, [www.azdhs.state.az.us](http://www.azdhs.state.az.us).

26 <sup>11</sup> Heat Deaths in Maricopa County, AZ Final Report 2012.

<http://www.maricopa.gov/publichealth/Services/EPI/pdf/heat/2012annualreport.pdf>

27 <sup>12</sup> AARP Public Policy Institute, "Affordable Home Energy and Health: Making the Connections," Lynne Page  
28 Snyder, PhD, MPH and Christopher A. Baker, June 2010, pp. 18-20.

1 past year, and 6% report the loss of either electrical or natural gas service  
2 for nonpayment.

- 3 • One in six (17%) report that they were unable to use their main heating  
4 source at some point during the previous year because they did not have the  
5 money to accomplish one or more of the following: fix or replace a broken  
6 furnace; purchase bulk fuel such as heating oil, propane or wood; or  
7 prevent the shutoff of utility service for nonpayment.  
8  
9 • One in eight (12%) report that they were unable to use their air-  
10 conditioning at some point during the previous year because they did not  
11 have the money to accomplish one or both of the following: fix or replace a  
12 broken air conditioner; or prevent the shutoff of electricity for  
13 nonpayment.  
14  
15

16 The National Energy Assistance Directors' Association conducted a survey in  
17 May of 2011 of Low Income Home Energy Assistance Program (LIHEAP)  
18 recipients and reports the following:<sup>13</sup>

- 19 • LIHEAP recipient households are likely to be vulnerable to temperature  
20 extremes;  
21  
22 • 40% of the homes had a senior in the household aged 60 or older;  
23  
24 • 42% had a disabled household member;  
25  
26 • 41% had a child 18 or younger;

---

26 <sup>13</sup> National Energy Association Directors' Association, 2011 National Energy Assistance Survey, Final Report,  
27 October 2011, [www.neada.org](http://www.neada.org)

- 1           • 89% had a least one vulnerable household member.

2           The study also provided information on challenges that these households faced:

- 3           • 35% were unemployed at some point during the previous year;  
4           • 72% had a serious medical condition;  
5           • 26% used medical equipment that requires electricity  
6

7           The NEADA study further reports indirect threats to health imposed by  
8 financial stress when various demands compete for their limited dollars include:

- 9           • 24% report going without food for a least one day because of energy bills in  
10           the past five years.  
11           • 37% report going without medical or dental care  
12           • 34% did not fill a medical prescription or took less than a full dose because  
13           of high energy bills. And finally,  
14           • 19% had someone in the home become sick because the home was too cold.  
15

16           The NEADA report goes on to emphasize the tremendous need for LIHEAP

- 17           • 65% of those who did not keep their home at unsafe or unhealthy  
18           temperatures said they would have done so if LIHEAP had not been  
19           available.  
20           • 63% of those who did not have their electricity or home heating fuel  
21           discontinued said that they would have if it had not been for LIHEAP.  
22

23           In spite of this staggering demand, only 5.5% of the Arizona households  
24  
25  
26  
27  
28

1 eligible for LIHEAP received assistance.<sup>14</sup> For those Arizonans unable to access  
2 energy assistance funds, the burden of their energy bill can be overwhelming. The  
3 energy burden, calculated as the amount spent on energy divided by a household's  
4 income, for Arizonans below the poverty line is 17.34%.<sup>15</sup> This is in stark contrast to  
5 the national average of 2.7%.<sup>16</sup> Families at 150% of the Federal Poverty Level had an  
6 energy burden of 13.49%, still dramatically outstripping the national average.  
7

8 Families unable to take advantage of energy assistance often experience food  
9 insecurity. A study in the journal *Pediatrics* reports children in LIHEAP families had  
10 lower odds of nutritional risk for depressed growth than children in eligible families  
11 that did not receive LIHEAP benefits.<sup>17</sup> Children in LIHEAP families had lower odds  
12 of acute hospitalization than children whose families did not receive LIHEAP  
13 benefits. The researchers conclude that households going without LIHEAP benefits  
14 have likely sacrificed their food budgets to maintain utility service, with their  
15 children's nutrition suffering as a result. Similar results have been shown for low-  
16 income elderly populations, where residents in high cooling states are 27% more  
17 likely to experience very low food security in the summer than in the winter. The  
18 authors noted that tradeoffs between food spending and energy costs are often made  
19 with significant human cost. These costs are amplified if home energy prices become  
20  
21  
22  
23

24 <sup>14</sup> "LIHEAP Needs at Least \$4.7 billion in Fiscal Year 2015," National Energy and Utility Affordability Coalition,  
Arizona.

25 <sup>15</sup> Home Energy Affordability Gap, [http://www.homeenergyaffordabilitygap.com/03a\\_affordabilityData.html](http://www.homeenergyaffordabilitygap.com/03a_affordabilityData.html)

26 <sup>16</sup> Energy Information Administration. <http://www.eia.gov/todayinenergy/detail.cfm?id=10891>

27 <sup>17</sup> Frank MD, Deborah A., et al. "Heat or Eat: the Low Income Home Energy Assistance Program and Nutritional  
and Health Risks Among Children Less than 3 Years of Age." *Pediatrics*. [www.pediatrics.org/cgi/doi/10.1542/peds.2005-2943](http://www.pediatrics.org/cgi/doi/10.1542/peds.2005-2943)

1 unusually high.

2 In Arizona in State Fiscal Year 2012, Community Action Agencies served a  
3 total of 227,126 individuals and 81,629 families. Of the households served, 71,082  
4 sought help with their utility bills, and 60,738 received utility assistance.<sup>18</sup> Agencies  
5 were able to serve on average, 1 in 10 of the eligible people seeking assistance.  
6

7 Q. What is the current state of the low-income assistance programs among the  
8 Utilities affected by this merger?

9 A. The utilities owned by UNS Energy offer a number of low-income programs.  
10

11 UNS Electric and Gas offer the Warm Spirits program, whereby customers  
12 donate to low-income customers on their bill, either by rounding up to the next  
13 dollar or pledging a monthly dollar amount. No contributions are used to  
14 administer the program, and as a result the administration and distribution of funds  
15 is itself unfunded.  
16

17 TEP makes annual contributions to Arizona Community Action Association  
18 from which bill assistance payments are made.

19 UNS Electric, Gas, and TEP participate in the low-income weatherization  
20 assistance program. This program yields tremendous results for low-income  
21 customers, significantly decreasing energy burdens while increasing comfort and  
22 making homes healthier and safer environments. For UNS Electric, the goal was  
23 to weatherize 130 in 2013, while 99 homes received weatherization assistance.<sup>19</sup>  
24  
25

26 <sup>18</sup> NASCSP Arizona CSBG IS 2010 Report.

27 <sup>19</sup> E-00000U-14-0049

1 TEP aspired to weatherize 145 homes; 93 homes were weatherized. UNS Gas  
2 intended to weatherize 113 homes, and was able to weatherize 102 houses.<sup>20</sup>

3 Q. What if any improvements could be made to the programs?

4 A. The Warm Spirits program has been tremendously helpful to hundreds of  
5 households in need. And the agencies who disburse the assistance funding do a  
6 magnificent job. Unfortunately, the Warm Spirits allocation doesn't include any  
7 money for program delivery or administration. As a result, the agencies rely on  
8 other funds to administer UNS Gas and Electric assistance. I would argue that a  
9 program is not fully funded if it does not account for the distribution of its  
10 assistance funding.  
11  
12

13 A significant improvement is TEP's bill assistance program, which was  
14 instituted in Decision No. 73912. This program has included in it funding for  
15 program delivery and administration, making it a more sustainable fund source  
16 and empowering the community agencies who distribute it to operate at higher  
17 efficiency and greater capacity.  
18

19 Q. Are you familiar with the low-income programs offered as a result of Fortis  
20 acquiring CH Energy Group?  
21

22 A. I am.

23 Q. Can you describe the provisions of that arrangement pertinent to low-income  
24 customers?  
25

26 A. Generally, Fortis has instituted a rate freeze through June 30, 2015. For low-

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27 <sup>20</sup> G-00000C-14-0105  
28



1 income customers specifically, those participating in the Home Energy Assistance  
2 Program received an increase in their previous monthly credits through a  
3 Community Benefit Fund. Also, Central Hudson agreed to waive reconnection  
4 fees for low-income program participants up to \$50,000.

5  
6 Q. Might such additions to the low-income programs in Arizona be an improvement?

7 A. Yes, I believe they would.

8 Q. How would the programs be improved?

9 A. We've received a number of anecdotal examples of customers who voluntarily  
10 disconnect their gas in the summer to pay for increased cooling bills. Allowing  
11 those customers to reconnect in the winter without penalty would allow them to  
12 avoid those critical tradeoffs listed above when choosing between health, nutrition,  
13 and utility service.  
14

15  
16 A rate freeze likewise would prove extremely beneficial to low-income  
17 customers. Electricity prices have been on the rise; residential rates have  
18 increased 40.6% in the past decade,<sup>21</sup> and low-income customers are often least  
19 able to afford the increases. Financial machinations of this scale are inherently  
20 uncertain, and if something not according to plan did happen, it could be most  
21 unfortunate for these utilities' low-income ratepayers. Combining this merger  
22 with a \$219 million purchase of Gila River Power Plant #3, it becomes all the  
23 more likely that customers would experience a rate shock. I believe that a rate  
24 freeze comparable to what was instituted when Fortis purchased CH Energy would  
25  
26

27 <sup>21</sup> Energy Information Administration.  
28

1 be the best way to maintain stability for vulnerable and low-income utility  
2 customers.

3 Referring back to the Home Energy Affordability Gap data, the average  
4 dollar amount by which actual home energy bills exceed affordable home energy  
5 bills for households below 200% of the Federal Poverty Line is \$548 per  
6 household. Combining this fact with the paltry 5.5% of eligible customers served  
7 by LIHEAP, there exists a significant need for energy assistance. If a similar  
8 community benefit fund could further increase the discount for low-income  
9 customers, this support would go a long way toward making energy more  
10 affordable for limited income customers of these utilities.

13 Q. What else could be done to support low-income assistance programs at or  
14 above current levels?

15 A. Unfortunately, low-income customers experience crises, in which case a  
16 discounted rate isn't enough to keep them from severe financial consequences. In  
17 that case, customers reach out for bill assistance, which, from all sources, is  
18 lacking. Utilities have donated funds to bill assistance in the past,<sup>22</sup> and that  
19 funding has gone on to provide additional financial security for a significant  
20 number of Arizonans. If Fortis were to do the same, it would demonstrate a real  
21 commitment to low-income assistance.

24 Finally, the best way to allow for customers to pay their bills is to make  
25 them more affordable in the first place. I applaud the company's support for  
26

27 <sup>22</sup> Decision No. 71448, E-01345A-08-0172

1 weatherization. Many community agencies report a long wait list for  
2 weatherization services, but can only help the clients for whom they have funding.  
3 If Fortis were to invest in weatherization, the impact would be felt many times  
4 over. Weatherization funds are leveraged with other sources, including federal  
5 dollars, so an increase in one source experiences a multiplier effect when deployed  
6 in the weatherization program. Expanding funding to the weatherization  
7 programs such that they can meet, and possibly surpass their goals for  
8 weatherization, would be a genuine commitment to low-income assistance.  
9

10 Q. Do you have any other comments regarding energy efficiency and demand  
11 side management?  
12

13 A. Previously I've testified that low-income customers should be held  
14 harmless from the DSMS surcharge. I still believe that low-income customers  
15 should not be charged for resources they cannot access. And to that end, I believe  
16 that DSM resources should be made available to low-income customers when  
17 practicable. One such example is the multifamily energy efficiency program  
18 offered by UNS Electric. A significant number of low-income ratepayers live in  
19 multifamily homes; multifamily efficiency programs should be allocated to low-  
20 income housing at least at a rate proportional to the number of low-income  
21 residents in multifamily housing in the utility's service territory.  
22

23  
24 But beyond that, low-income customers benefit along with all other  
25 customers when efficiency is added to the grid. Energy efficiency is a least-cost  
26 resource by definition; when one of the Utilities procures efficiency rather than a  
27  
28

1 higher cost resource, those savings are available for everyone, low-income  
2 customers included. When these savings accumulate en masse, real value accrues  
3 to the customers. Lawrence Berkeley National Laboratory found that APS and  
4 TEP would save over \$7 Billion by implementing the Energy Efficiency Standard;  
5 it would seem that one of the best ways to protect low-income ratepayers is to  
6 keep them from having to pay for unnecessary transmission and generation  
7 projects. Indeed, to support low-income customers, Fortis must also support  
8 energy efficiency.  
9

10 Q. Are there any other comments you'd like to add?  
11

12 A. I'd like to restate my appreciation for the Utilities' previous efforts to  
13 address low-income issues. In this moment of flux we have an opportunity to  
14 make even greater strides in protecting vulnerable ratepayers. As I've stated  
15 previously, the need for energy assistance is great, and the effect it has can impact  
16 health, nutrition, and even housing security. A community development fund for  
17 low-income discounts, bill assistance, and weatherization would all greatly  
18 increase the well-being and resiliency of low-income ratepayers. A fund that  
19 increases bill assistance while providing program administration funding provides  
20 the dual benefits of assisting low-income customers while also increasing the  
21 robustness and capacity of the utility assistance program as a whole. And, support  
22 for low-income customers has to include procuring least-cost resources through  
23 well-supported DSM plans.  
24  
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1 Q.

Does this conclude your testimony?

2 A.

Yes, it does.

3

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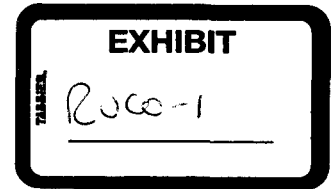
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UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011  
DOCKET NO. E-01933A-14-0011



DIRECT TESTIMONY  
OF  
PATRICK J. QUINN  
IN  
SUPPORT OF THE SETTLEMENT AGREEMENT

ON BEHALF OF  
THE  
RESIDENTIAL UTILITY CONSUMER OFFICE

JUNE 2, 2014

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**EXECUTIVE SUMMARY**

The Arizona Residential Utility Consumer Office ("RUCO") presents the direct testimony of RUCO Director Patrick J. Quinn in support of the Proposed Settlement Agreement reached in the matter of the reorganization of UNS Energy. Mr. Quinn recommends that the Arizona Corporation Commission approve the Proposed Settlement Agreement for the following reasons:

The Proposed Settlement Agreement reflects an outcome that is fair to both the ratepayer, UNS Energy, and FORTIS and is in the public interest.

The Proposed Settlement Agreement is a comprehensive settlement agreement. Its terms settle a wide range of issues that were of significant interest to the settling parties

The Proposed Settlement Agreement contains numerous ratepayer benefits and resolves several areas of importance to RUCO in the acquisition of UNS by FORTIS, all of which will be explained more fully in Mr. Quinn's testimony.



**INTRODUCTION**

**Q. Please state your name, occupation and business address for the record.**

A. My name is Patrick J. Quinn. I am the Director of the Arizona Residential Utility Consumer Office ("RUCO"). My business address is 1110 W. Washington Street, Suite 220, Phoenix, Arizona 85007.

**Q. Please state your educational background and qualifications in the utility regulation field.**

A. I have a BS in Mathematics and a MBA from the University of South Dakota. Additionally, I have 35 plus years of experience in the Telecommunications Industry and the Consulting business dealing with utility regulation. I have testified over 50 times before state and federal regulatory commissions on issues including finance, economics, pricing, policy and other related areas.

**Q. What is the purpose of your testimony?**

A. The purpose of my testimony is to explain RUCO's support of the UNS Energy/Fortis ("UNS/FORTIS") reorganization Proposed Settlement Agreement ("Agreement or Settlement").

...

...

1 **Q. Have you participated in other settlement negotiations?**

2 A. Yes. I have participated in settlement negotiations in other matters that  
3 have come before the Arizona Corporation Commission ("ACC" or  
4 "Commission") both from the utility and consumer side. The majority of  
5 these negotiations have resulted in reaching an accord with the utility and  
6 the other settling parties, leading to the signing and supporting of a  
7 settlement agreement. On the other hand, I have walked away from  
8 settlement talks when negotiations produced a result I could not support. I  
9 have been involved in several recent negotiations where I represented  
10 RUCO. Some have resulted in settlements and others did not settle  
11 because RUCO found that they were not in the best interest of residential  
12 ratepayers. RUCO does not enter into settlements lightly. RUCO will not  
13 agree to settle simply as a means of avoiding litigation. However, in this  
14 matter, negotiations did produce reasonable and fair terms that RUCO can  
15 and does support.

16  
17 **THE SETTLEMENT PROCESS**

18 **Q. Was the negotiation process that resulted in the Settlement**  
19 **Agreement a proper and fair process?**

20 A. Yes. The Agreement is the result of numerous hours of negotiation and a  
21 willingness among the parties to compromise. The negotiations were  
22 conducted in a fair and reasonable way that allowed each party the  
23 opportunity to participate. All intervenors had an opportunity to participate

1 in every step of the negotiation. Notice for each scheduled meeting was  
2 sent to all parties electronically. Persons were able to participate via  
3 teleconference, if necessary.

4  
5 By RUCO's count, at least 13 parties participated in the Agreement.  
6 These participants represent a wide range of interests including  
7 homebuilders association, consumer organizations, industry, union, many  
8 other organizations, Commission Staff ("Staff") and RUCO.

9  
10 **Q. Did all the parties sign the Agreement?**

11 A. No. At the very end, twelve parties chose to sign the Agreement. The  
12 parties that did not sign have the opportunity to file testimony to explain  
13 their reasons for not signing the Agreement.

14  
15 **Q. Why is a negotiated settlement process an appropriate way to**  
16 **resolve this matter?**

17 A. By its very nature, a settlement finds middle ground that the parties can  
18 support. All the parties that participated in the settlement talks were  
19 sophisticated parties who were well seasoned in the ACC's regulatory  
20 processes and veterans of the negotiating table. The fact that twelve  
21 parties representing such varied interests were able to come together to  
22 reach consensus illustrates the balance, moderation and compromise of  
23 the document.

1 Settlement negotiations began only after each party had the opportunity to  
2 analyze UNS/FORTIS' Application, file its direct testimony and read the  
3 direct testimony of other Intervenors. Of course, the Agreement in no way  
4 eliminates the ACC's constitutional right and duty to review this matter and  
5 to make its own determination whether the Agreement is truly balanced  
6 and in the public interest.

7  
8 **Q. Do you have any general comments you would like to make.**

9 A. Yes. The acquisition of UNS by FORTIS Inc. is different than many of the  
10 acquisitions I have been involved in. This was not an acquisition of two  
11 companies where there would be a lot of possibilities of synergies and  
12 cost reductions. Basically FORTIS was acquiring UNS and leaving its  
13 management, operations and decision making in Tucson. They were not  
14 getting folded into FORTIS in the traditional sense. This made it  
15 somewhat more difficult to find big expense savings to provide givebacks  
16 to the ratepayers. Having said that the final Settlement does contain  
17 many significant benefits to the residential ratepayers. The Settlement did  
18 include 66 terms and conditions, some with many parts. I will discuss  
19 below the significant conditions that the residential ratepayer received for  
20 supporting approval of this acquisition.

**SUMMARY OF TESTIMONY**

**Q. Please summarize your testimony.**

A. The Agreement reflects an outcome that is fair to the consumer, UNS Energy and Fortis and is in the public interest. Furthermore, this is a comprehensive agreement. Its terms settle a wide range of issues that were of significant interest to several of the intervenors.

RUCO supports the Agreement in its entirety because it contains numerous benefits to the consumer.

**SETTLEMENT PROVISIONS**

**Q. In summary, what are the major benefits to the residential consumer?**

A. The major benefits to the residential consumer are as follows:

- Ratepayer credits totaling \$30 million over 5 years (Condition 1)
- Within 60 days of closing FORTIS will infuse \$220 million of equity into UNS (Condition 2) which among other things will improve the utilities' equity ratio.
- FORTIS is a much larger Company than UNS Energy which when acquired, should result in greater access by the utility to the financial markets as well as cheaper debt and equity. The ratepayers should see lower rates overall as a result.

- 1           • Any tax benefits realized from the sale and buy back of treated coal will
- 2           be passed onto the TEP ratepayers through the PPFAC (Condition 3)
- 3           • All future Rate Cases filed through 2020 shall show that the proposed
- 4           rate increases are lower than they would have been absent the
- 5           acquisition (Condition 4)
- 6           • Several provisions about not seeking recovery from the ratepayers of a
- 7           variety of costs associated with the acquisition (Conditions 5 thru
- 8           11,13)
- 9           • Several provisions to improve UNS' capital structure and credit quality
- 10          (Conditions 16 thru 25)
- 11          • The Company will maintain or improve service quality (Conditions 28
- 12          thru 30)
- 13          • Commitment to maintain Corporate governance in Tucson, Arizona
- 14          (Conditions 39 thru 42)

15

16   **PUBLIC INTEREST**

17   **Q.   How is the public interest satisfied by the Agreement?**

18   **A.**   At the most fundamental level, the Agreement satisfies the public interest

19          from RUCO's perspective in that it provides favorable terms and key

20          protections for residential consumers as defined above. Taken together

21          the Settlement's conditions adequately mitigate the risk identified in the

22          prior testimonies of Ralph Smith and Lon Huber. The Agreement also

23          satisfies the public interest by providing a fair and balanced approach in

1 supporting the acquisition of UNS by FORTIS and allowing the Company  
2 the opportunity to be successful. Further, the acquisition will not impair the  
3 utilities financial position, but rather enhance it.  
4

5 **AREAS OF IMPORTANCE**

6 **Q. You mentioned several areas of importance that are critical for RUCO**  
7 **to sign on to the Agreement. Would you like to address them?**

8 A. Yes. Any time there is an acquisition RUCO tries to identify synergy cost  
9 savings that can be shared with the residential ratepayer. However, in this  
10 particular acquisition of UNS by FORTIS there is not the typical large  
11 scale synergies but there are some synergies nonetheless. Basically  
12 Fortis is acquiring UNS and leaving it operationally intact as an  
13 independent company in Tucson. Therefore, Condition 1 of the Agreement  
14 where the Company agreed to ratepayer rate credits of \$30 million over  
15 the next 5 years was acceptable to RUCO when joined with the additional  
16 protections contained in the Agreement. This is a direct benefit that will be  
17 seen by ratepayers. Perhaps less direct, but of great importance is the  
18 stronger financial position that the utility will be in as a result of the  
19 acquisition. The greater access to the financial markets coupled with the  
20 cheaper costs of equity and debt should save ratepayers money. Finally,  
21 by the terms of the Agreement, the Company is required to show that its  
22 rates under the acquisition will be lower in any rate cases through 2020.

1           That one provision alone will result in ratepayers being better off than the  
2           status quo at least through 2020 should a rate case be filed.

3

4       **Q.   Another area of concern was the capital structure of UNS. The**  
5       **capital structure was mostly made up of debt. Did FORTIS agree to**  
6       **help this situation?**

7       A.   Yes, In Condition 2 of the Agreement FORTIS agreed to infusion \$220  
8       million of equity into UNS. Additionally, in Condition 16 FORTIS agreed to  
9       limit its dividend payout from UNS to FORTIS to no more than 60 percent  
10      of annual earnings for 5 years to help balance TEP's capital structure.  
11      These measures should help strengthen the financial position of UNS  
12      Energy and its three Arizona regulated utilities (i.e. Tucson Electric Power,  
13      UNS Electric and UNS Gas).

14

15      **Q.   Are there any other financial benefits to the ratepayer in the**  
16      **Agreement?**

17      A.   Yes. UNS has a potential arrangement to sell coal to a third party which  
18      treats the coal and sells it back to UNS for use in their generating plants.  
19      There are IRS benefits generated by treating this coal. FORTIS in  
20      Condition 3 agreed to pass onto the TEP ratepayers through the PPFAC  
21      the cost savings and financial benefits generated from this type of coal  
22      treatment transaction. This would be a direct reduction to a cost paid by  
23      the ratepayers.



1 **Q. Additionally there is always concerns that Companies will try to pick**  
2 **up costs associated with the acquisition or acquisition later on from**  
3 **the ratepayer. Have the ratepayers been protected from that in this**  
4 **Agreement?**

5 A. Yes. This was one of the critical concerns of RUCO. The Agreement  
6 addresses our concerns completely. There are several Conditions that  
7 address issues including goodwill, shareowner litigation costs, retention  
8 payments, acquisition premiums, transaction costs and other related  
9 costs. These are identified more in Conditions 5 through 15 of the  
10 Agreement. These Conditions provide great protection for ratepayers in  
11 the future.

12  
13 **Q. Are there any other Conditions you would like to discuss?**

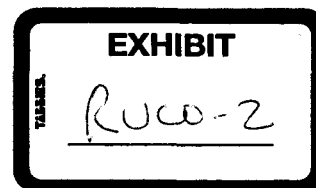
14 A. Yes. I have only discussed a few of the 66 Conditions of the Agreement  
15 that were very important to RUCO. Others of the Agreement are also  
16 important like keeping local control in Tucson. Given the totality of the  
17 Agreement RUCO is very supportive of the acquisition of UNS by  
18 FORTIS.

19  
20 **Q. Does this conclude your testimony on the Agreement?**

21 A. Yes it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP - Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH



IN THE MATTER OF THE REORGANIZATION OF  
UNS ENERGY CORPORATION

) DOCKET NO. E-04230A-14-0011  
) DOCKET NO. E-01933A-14-0011  
)

TESTIMONY IN SUPPORT  
OF THE SETTLEMENT AGREEMENT  
OF  
RALPH C. SMITH  
ON BEHALF OF THE  
RESIDENTIAL UTILITY CONSUMER OFFICE  
JUNE 2, 2014

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## ATTACHMENTS

None.

**I. INTRODUCTION**

**Q. Please state your name, position and business address.**

A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC, 15728 Farmington Road, Livonia, Michigan 48154.

**Q. Are you the same Ralph C. Smith who provided direct testimony on behalf of Residential Utility Consumer Office ("RUCO") in this proceeding?**

A. Yes.

**Q. What is the purpose of the testimony you are presenting?**

A. The purpose of my testimony is to support the Settlement among the parties that was filed on May 16, 2014 concerning the acquisition of UNS Energy by Fortis, Inc. Specifically, I address how the Settlement has incorporated most of the additional or modified conditions that I had recommended in my direct testimony, and generally how the conditions contained in the Settlement improve upon the acquisition that had originally been proposed by the Joint Applicants. I also discuss how the Settlement provides for significant tangible ratepayer benefits, something which had not been included in the Joint Applicants' initial proposal.

**Q. Have you prepared any attachments to be filed with your testimony in support of the Settlement?**

A. No.

**II. TESTIMONY AND CONCLUSIONS**

**Q. Please summarize your testimony and conclusions.**

A. The Settlement incorporates a number of additional conditions based on recommendations by RUCO and other parties, such as Staff, to help protect Arizona ratepayers from some of the risks that the proposed acquisition would have otherwise presented and to provide significant tangible benefits to Arizona ratepayers. Notably, in addition to having significantly improved ratepayer protections, the Settlement also incorporates an important provision for the provision of specific tangible ratepayer benefits, which had been lacking in the Joint Applicants' initial proposal.

**Q. What additional or modified conditions had you recommended be imposed on the proposed transaction to prevent harm to Arizona ratepayers and provide for specific tangible benefits?**

A. My direct testimony included the following recommended additional or modified conditions:

- Fortis and UNS Energy agree to provide economic customer benefit adjustments totaling \$59 million.<sup>1</sup> These benefits will include both immediate and long term benefits. RUCO is still working on defining these benefits and will either supplement this testimony or provide details of the nature of the benefits in its surrebuttal case. This amount is based on UNS being larger than Central Hudson and Central Hudson received the equivalent of \$49 million in customer benefits.
- In the event that Fortis completes any additional mergers or acquisitions within the United States before the Commission adopts an order approving new base rates for TEP, Fortis must share the follow-on merger savings that are reasonably applicable to TEP, UNS Electric and UNS Gas and their customers between shareholders and ratepayers, on a 50/50 basis, to the extent the portions of such savings realized by Fortis are material (i.e., 5 percent or more of TEP, UNS Electric and UNS Gas net income on an after-tax basis). UNS Energy must submit, within 90 days of the follow-on merger closing, a comprehensive and detailed proposal to share the follow-on merger savings,

<sup>1</sup> This compares with \$44.25 million (\$9.25 million plus \$35 million) of ratepayer benefits guaranteed by Fortis in its acquisition of the Central Hudson utilities in New York, and \$5 million for a Community Benefit Fund for economic development and low income purposes for that Central Hudson acquisition. See, e.g., RUCO Fortis 1.04 Attachment A, UNS (0011) 001819-1820, included in Attachment RCS-5, that was attached to my Direct Testimony.

1 to begin on the closing date of the follow-on merger. In addition, the proposal must  
2 include an allocation method for sharing the synergy savings and efficiency gains  
3 among corporate entities that addresses the time period from the receipt of the synergy  
4 savings by TEP, UNS Electric and UNS Gas until the Commission approves new rates.  
5 The ratepayer share shall be set aside in a deferral account for future Commission  
6 disposition.<sup>2</sup>

- 7 • Fortis and UNS Energy agree and commit that none of the shareholder litigation costs  
8 shall be borne by the ratepayers of TEP, UNS Electric or UNS Gas.<sup>3</sup>
- 9 • Fortis and UNS Energy agree and commit that all Change of Control costs and  
10 Retention Bonus costs are transaction costs and none of those costs shall be borne by  
11 the ratepayers of TEP, UNS Electric or UNS Gas.<sup>4</sup> None of the transaction costs related  
12 to this acquisition and merger shall be borne by the ratepayers of TEP, UNS Electric or  
13 UNS Gas.
- 14 • Fortis and UNS Energy agree and commit that all benefits of the plans to sell coal to  
15 third parties for treatment to generate Internal Revenue Code §45 credits and to buy-  
16 back treated coal for burn at Springerville 1 and 2 (and at any other TEP coal-fired  
17 generating plants where such arrangements are established) will be passed onto TEP  
18 ratepayers through the PPFAC as described in the response to RUCO UNS 2.07.<sup>5</sup>
- 19 • Fortis and UNS Energy shall report to the Commission within five business days any  
20 changes in the credit ratings of Fortis, Inc., UNS Energy, TEP, UNS Electric or UNS  
21 Gas.

22  
23 **Q. Does the Settlement include most of those additional conditions that you had**  
24 **recommended?**

25 **A.** Yes, it does. Specifically, the Settlement includes the following conditions, which, as I will  
26 describe, correspond to the ones listed above from my direct testimony.

27  
28 This condition, provided for in the Settlement Conditions at paragraph 12, for "add on"

---

<sup>2</sup> This is similar to the provision for Follow-On Merger Savings that Fortis committed to in its acquisition of the Central Hudson utilities in New York. See, e.g., RUCO Fortis 1.04 Attachment A, page UNS (0011) 001816, included in Attachment RCS-5, attached to my Direct Testimony.

<sup>3</sup> See, e.g., Response to RUCO Fortis 2.09, a copy of which is included in Attachment RCS-5, attached to my Direct Testimony.

<sup>4</sup> See, e.g., Responses to RUCO Fortis 2.32, 2.11 and 2.02 and RUCO UNS 1.04, copies of which are included in Attachment RCS-6, that was filed with my Direct Testimony.

<sup>5</sup> A copy of the response to RUCO UNS 2.07 was included in Attachment RCS-5, filed with my Direct Testimony.

1 merger benefits, is similar to the condition in the second bullet point from my Direct  
2 Testimony recommendations:

3 12. In the event that Fortis completes any additional mergers or acquisitions  
4 within the United States before the Commission adopts an order approving  
5 new rates for the Regulated Utilities, Fortis must share the follow-on merger  
6 savings that are reasonably applicable to the Regulated Utilities and their  
7 customers between shareholders and ratepayers, on a 50/50 basis, to the  
8 extent the portions of such savings realized by Fortis are material (i.e., 5  
9 percent or more of UNS Energy's consolidated net income on an after-tax  
10 basis). UNS Energy must submit, within 90 days of the follow-on merger  
11 closing, a comprehensive and detailed proposal to share the follow-on  
12 merger savings, to begin on the closing date of the follow-on merger.

13 The following condition, provided for in the Settlement Conditions at paragraph 7, which  
14 protects Arizona ratepayers from having to pay for the cost of shareholder litigation,  
15 compares with my recommendation in the third bullet point listed above:

16 7. Fortis and UNS Energy shall not pass any costs of the shareholder  
17 litigation related to the merger to ratepayers of the Regulated Utilities.  
18

19 The following condition, provided for in the Settlement Conditions at paragraph 8, which  
20 protects Arizona ratepayers from having to pay for transaction and transition costs,  
21 including Change of Control and Retention payments related to the merger, compares with  
22 my recommendation in the fourth bullet point listed above:

23 8. Fortis, UNS Energy, and/or the Regulated Utilities shall not seek recovery  
24 of or on the transaction and transition costs associated with the merger, and  
25 agree that any Change of Control and Retention payments related to the  
26 merger will not be borne by the ratepayers of the Regulated Utilities.

27 The following condition, provided for in the Settlement Conditions at paragraph 3, to  
28 formalize TEP's previously stated commitment to pass onto ratepayers benefits resulting  
29 from a Section 45 coal treatment and buy-back arrangement, is similar to my  
30 recommendation in the fifth bullet point listed above:

3. Fortis and UNS Energy agree and commit that benefits from the sale of coal, that would otherwise be used for TEP generation, to third parties for treatment to generate Internal Revenue Code Sec. 45 credits and to buy-back treated coal for burn at Springerville 1 and 2 (and any other TEP coal-fired generating plants where such arrangements are established) will be passed onto TEP ratepayers through the PPFAC.

**Q. How does the Settlement provide for tangible ratepayer benefits?**

A. The Settlement includes the following condition to provide for tangible ratepayers benefits and savings:

**1. Ratepayer Benefits/Savings - Ratepayer Benefits/Savings -** UNS Energy shall provide ratepayer credits totaling \$30 million over 5 years, to be shared by the customers of TEP, UNS Electric and UNS Gas (referred to collectively as the "Regulated Utilities") as follows:

(a) A total of \$10 million in year one (commencing October 1, 2014) with \$5 million being payable to customers as a bill credit to be applied to the monthly customer charge in an amount proportional to the average customer charge in each class and \$5 million to be passed through to customers as a per kWh or per therm credit through the Regulated Utility's PPFAC or PGA.

(b) A total of \$5 million per year in years 2 through 5 payable to customers as a bill credit to be applied to the monthly customer charge in an amount proportional to the average customer charge in each class.

(c) All bill credits payable under subsections (a) and (b) hereof shall commence October 1st of each applicable year and be completed within six (6) months, i.e., by the following March 1st.

The Settlement thus provides for tangible ratepayer benefits, albeit in an amount (\$30 million) that is less than the \$59 million that I had recommended. The Settlement provision noted above also provides a specific mechanism for delivering the \$30 million of benefits to Arizona ratepayers. This provision is a significant improvement over the Joint Applicants' initial proposal, which had not provided for any tangible ratepayer benefits.

**Q. How does the Settlement address reporting for changes in the credit ratings of Fortis, Inc., UNS Energy, TEP, UNS Electric and UNS Gas?**



1 A. The Settlement provides in Attachment A, Settlement Conditions, at paragraph 45, that:  
2 "Fortis and UNS Energy shall report to the Commission and RUCO within ten (10) business  
3 days any changes in the credit ratings of Fortis, Inc., UNS Energy, or the Regulated  
4 Utilities."<sup>6</sup>

5  
6 **Q. Why do you believe that it is important that the Commission and interested parties be**  
7 **informed with reasonable promptness (i.e., per the Settlement, within ten business**  
8 **days) of changes in such credit ratings?**

9 A. The acquisition of UNS Energy by Fortis has been cited as potentially improving the  
10 financial strength and credit ratings of UNS Energy and its Arizona utilities; however, there  
11 are some risks associated with the transaction, one being the large amount of Goodwill  
12 which is resulting from the acquisition, which could become impaired at some point, and  
13 affect the strength of Fortis' balance sheet.

14 Improved credit ratings could be expected to reduce the borrowing costs of the three  
15 Arizona Regulated Utilities (TEP, UNS Electric and UNS Gas) that are being acquired by  
16 Fortis. In contrast, lowered credit ratings could increase borrowing costs and impede the  
17 ability of the Regulated Utilities' access to capital on reasonable terms. I note that the  
18 proposed transaction, with the additional and improved conditions that are provided for in  
19 the Settlement, is expected to result in an improvement to the financial strength and access  
20 to capital of UNS Energy and the three Arizona utilities. While it may be expected that  
21 credit ratings will improve under Fortis' ownership, that is not guaranteed and the opposite  
22 could potentially occur. Receiving prompt notification of changes in credit ratings of Fortis,  
23 UNS Energy and the Regulated Utilities is thus important to monitoring changes in the  
24 financial health of these Arizona utilities.

---

<sup>6</sup> My original recommendation had been for such reporting within five business days; however, having such reporting occur within ten business days provides for reasonable promptness.

1  
2 **Q. Does the Settlement also include other conditions that were recommended by Staff?**

3 A. Yes. The Settlement also includes a number of other additional or modified conditions that  
4 were recommended by Staff which help provide protection to Arizona ratepayers from some  
5 of the risks of the proposed transaction. The following are illustrative examples of two of  
6 the conditions recommended by Staff that have been included in the Settlement and which  
7 improve the proposed transaction:

8 2. Within sixty (60) days of the closing, Fortis shall make an equity infusion  
9 through UNS Energy into the Regulated Utilities totaling \$220 million.  
10 However, if the transaction closes after September 30, 2014, the equity  
11 infusion may be made into UNS Energy to retire debt.

12 4. In all rate cases filed by the Regulated Utilities through 2020, with a test  
13 year ending on or after December 31, 2015, the Regulated Utilities shall  
14 show that the proposed rate increases are demonstratively lower than those  
15 that would have been proposed absent the acquisition of UNS Energy by  
16 Fortis.

17 Several of the other additional or modified conditions proposed by Staff (or other parties)  
18 which have been incorporated into the Settlement, taken as package, significantly improve  
19 upon the transaction that was originally proposed by the Joint Applicants.

20 **Q. Are you satisfied that the additional conditions that have been imposed on the**  
21 **proposed transaction by the Settlement have resulted in significant improvements to**  
22 **the proposed transaction in comparison to the Joint Applicants' initial proposal?**

23 A. Yes.  
24

25 **Q. Does your testimony address the ultimate question of whether the proposed**  
26 **transaction, with the improved conditions that are being imposed via the Settlement,**  
27 **is in the public interest?**

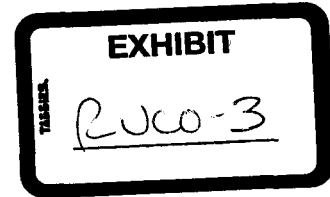
1 A. No. RUCO witness Patrick Quinn presents RUCO's position concerning whether the  
2 proposed transaction, with the additional conditions that are provided for in the Settlement,  
3 is in the public interest.

4  
5 **Q. Does this conclude your testimony in support of the Settlement?**

6 A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP - Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH



IN THE MATTER OF THE REORGANIZATION OF  
UNS ENERGY CORPORATION

) DOCKET NO. E-04230A-14-0011  
) DOCKET NO. E-01933A-14-0011  
)

DIRECT  
TESTIMONY  
OF  
RALPH C. SMITH  
ON BEHALF OF THE  
RESIDENTIAL UTILITY CONSUMER OFFICE  
APRIL 30, 2014

[CONFIDENTIAL AND COMPETITIVELY SENSITIVE Information has been Redacted]

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Illustrative news articles about the current status of an acquisition of a former Texas utility, TXU, by a buyout group that had included KKR & Co. L.P. ("KKR" aka Kohlberg Kravis Roberts, an investment firm that had been part of the consortium that had previously attempted to acquire UNS Energy in 2005), and some new articles about high profile Goodwill impairment write-offs that have occurred after other acquisition/merger transactions. ....	RCS-4
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1     **I.   INTRODUCTION**

2     **Q.   Please state your name, position and business address.**

3     A.   Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC,  
4         15728 Farmington Road, Livonia, Michigan 48154.

5  
6     **Q.   Please describe Larkin & Associates.**

7     A.   Larkin & Associates is a Certified Public Accounting and Regulatory Consulting firm.  
8         The firm performs independent regulatory consulting primarily for public service/utility  
9         commission staffs and consumer interest groups (public counsels, public advocates,  
10        consumer counsels, attorneys general, etc.). Larkin & Associates has extensive experience  
11        in the utility regulatory field as expert witnesses in over 600 regulatory proceedings  
12        including numerous electric, gas, telephone, and water and sewer matters.

13  
14    **Q.   Mr. Smith, please summarize your educational background.**

15    A.   I received a Bachelor of Science degree in Business Administration (Accounting Major)  
16         with distinction from the University of Michigan - Dearborn, in April 1979. I passed all  
17         parts of the Certified Public Accountant ("C.P.A.") examination in my first sitting in 1979,  
18         received my CPA license in 1981, and received a certified financial planning certificate in  
19         1983. I also have a Master of Science in Taxation from Walsh College, 1981, and a law  
20         degree (J.D.) cum laude from Wayne State University, 1986. In addition, I have attended  
21         a variety of continuing education courses in conjunction with maintaining my accountancy  
22         license. I am a licensed C.P.A. and attorney in the State of Michigan. I am also a  
23         Certified Financial Planner™ professional and a Certified Rate of Return Analyst  
24         ("CRRRA"). Since 1981, I have been a member of the Michigan Association of Certified  
25         Public Accountants. I am also a member of the Michigan Bar Association and the Society  
26         of Utility and Regulatory Financial Analysts ("SURFA"). I have also been a member of

1 the American Bar Association (ABA), and the ABA sections on Public Utility Law and  
2 Taxation.

3  
4 **Q. Please summarize your professional experience.**

5 A. Subsequent to graduation from the University of Michigan, and after a short period of  
6 installing a computerized accounting system for a Southfield, Michigan realty  
7 management firm, I accepted a position as an auditor with the predecessor CPA firm to  
8 Larkin & Associates in July 1979. Before becoming involved in utility regulation where  
9 the majority of my time for the past 34 years has been spent, I performed audit,  
10 accounting, and tax work for a wide variety of businesses that were clients of the firm.

11 During my service in the regulatory section of our firm, I have been involved in  
12 rate cases and other regulatory matters concerning electric, gas, telephone, water, and  
13 sewer utility companies. My present work consists primarily of analyzing rate case and  
14 regulatory filings of public utility companies before various regulatory commissions, and,  
15 where appropriate, preparing testimony and schedules relating to the issues for  
16 presentation before these regulatory agencies.

17 I have performed work in the field of utility regulation on behalf of industry, state  
18 attorneys general, consumer groups, municipalities, and public service commission staffs  
19 concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona,  
20 Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Indiana, Illinois,  
21 Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota,  
22 Mississippi, Missouri, New Jersey, New Mexico, New York, Nevada, North Carolina,  
23 North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont,  
24 Virginia, Washington, Washington D.C., West Virginia and Canada as well as the Federal  
25 Energy Regulatory Commission and various state and federal courts of law.  
26



1 **Q. Have you prepared an attachment summarizing your educational background and**  
2 **regulatory experience?**

3 A. Yes. Attachment RCS-1 provides details concerning my experience and qualifications.  
4

5 **Q. On whose behalf are you appearing?**

6 A. I am appearing on behalf of the Residential Utility Consumer Office ("RUCO").  
7

8 **Q. Have you previously testified before the Arizona Corporation Commission?**

9 A. Yes. I have previously testified before the Commission on a number of occasions. As  
10 illustrative examples, in 2000, I filed testimony on behalf of the Commission Utilities  
11 Division Staff in Docket No. T-1051B-99-0497, involving the merger of the parent  
12 companies of Qwest Communications Corporation, LCI International Telecom Corp. and  
13 U.S. West Communications, Inc. I testified before the Commission in Docket No. E-  
14 01345A-06-0009, involving an emergency rate increase request by Arizona Public Service  
15 Company ("APS" or "Company"), APS' Docket Nos. E-01345A-05-0816, E-01345A-05-  
16 0826 and E-01345A-05-0827, concerning proceedings involving APS base rates and other  
17 matters, Docket No. E-01345A-08-0172, concerning an emergency rate increase and  
18 general rate case request and the most recent APS case, Docket No. E-01345A-11-0224. I  
19 also testified before the Commission in UNS Gas, Inc. rate cases, Docket Nos. G-04204A-  
20 11-0158, G-04204A-08-0571, G-04204A-06-0463, G-04204A-06-0013 and G-04204A-  
21 05-0831, and in UNS Electric, Inc. rate cases Docket No. E-04204A-06-0783 and E-  
22 04204A-12-0504, as well as Southwest Gas Corporation rate cases, G-01551A-07-0504  
23 and G-01551A-10-0458. I testified before the Commission in the Arizona-American  
24 Water Company in Docket Nos. W-01303A-09-0343 and SW-01303A-09-0343. I have  
25 also presented testimony in Tucson Electric Power Company rate cases, Docket Nos. E-  
26 01933A-07-0402 and E-01933A-12-0291, among others.

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**Q. What is the purpose of the testimony you are presenting?**

A. The purpose of my testimony is to address the proposed acquisition of UNS Energy by Fortis, Inc.

**Q. Which Arizona public utilities are involved in the proposed merger?**

A. The proposed merger of Fortis and UNS involves these UNS utility subsidiaries:  
Tucson Electric Power Company ("TEP")  
UNS Electric, Inc. ("UNSE")  
UNS Gas, Inc. ("UNSG")

**Q. What information did you review in conducting your analysis?**

A. I reviewed the Joint Notice of Intent to Reorganize, the direct testimony of UNS Energy and Fortis, responses to data requests, UNS Energy's confidential and competitively sensitive "due diligence" documentation, the Fortis confidential and competitively sensitive "due diligence" documentation, and public information.

**Q. Have you prepared any attachments to be filed with your testimony?**

A. Yes. Attachments RCS-1 through RCS-7 contain additional background and qualifications information and copies of selected documents that are referenced in my testimony.

**Q. Please briefly explain what is included in each of those attachments.**

A. Attachment RCS-1 contains additional information on my Background and Qualifications.  
Attachment RCS-2 presents the pre- and post-merger corporate organizational charts that were presented by Joint Applicants as Exhibit 2 to their application.

1 Attachment RCS-3 presents a corporate organizational chart for Fortis, Inc. (as of  
2 February 2014).

3 Attachment RCS-4 presents some illustrative news articles about the current status  
4 of an acquisition of a former Texas utility, TXU, by a buyout group that had included  
5 KKR & Co. L.P. ("KKR" aka Kohlberg Kravis Roberts, an investment firm that had been  
6 part of the consortium that had previously attempted to acquire UNS Energy in 2005), and  
7 some new articles about high profile Goodwill impairment write-offs that have occurred  
8 after other acquisition/merger transactions.

9 Attachment RCS-5 contains copies of UNS Energy and Fortis' non-confidential  
10 responses to data requests and other non-confidential material referenced in testimony.

11 Attachment RCS-6 contains selected Confidential material that is referenced in my  
12 testimony.

13 Attachment RCS-7 contains two pages of information from UNS Energy  
14 Confidential and Competitively Sensitive "due diligence" material referenced in  
15 testimony.

16  
17 **Q. You mentioned UNS Energy and Fortis "due diligence" materials. Can you please**  
18 **briefly explain what the "due diligence" materials are?**

19 **A.** Yes. In a major acquisition transaction, such as this one, both the seller (in this case UNS  
20 Energy) and the buyer (in this case Fortis) prior to entering into a formal acquisition and  
21 merger agreement, will engage in detailed investigations to help ensure, from the seller's  
22 perspective, that it is getting a fair price for the stock sale, and, from the buyer's  
23 perspective, that it has a sufficiently detailed understanding of the company that it is  
24 buying, including the condition of the system and the operating environment, as well as  
25 risk factors that may be present. These investigations by the seller and buyer are  
26 commonly referred to as "due diligence." Typically, the investigations include advice

1 from investment banking firms/financial advisors, as well as legal, engineering,  
2 accounting, operational and technical advisors.

3  
4 **II. SUMMARY OF TESTIMONY AND CONCLUSIONS**

5 **Q. Please summarize your testimony and conclusions.**

6 A. The proposed transaction entails risks to ratepayers of the Arizona Utilities that should be  
7 mitigated by imposing some additional conditions on the proposed transaction and  
8 tightening up, via use of improved specific enforceable language, some of the  
9 commitments that are being offered by the Joint Applicants. Additionally, a provision for  
10 specific tangible ratepayer benefits should be included in the conditions to be imposed on  
11 the proposed transaction.

12  
13 **Q. Please summarize your recommended additional conditions that should be imposed**  
14 **on the proposed transaction to prevent harm to Arizona ratepayers and provide for**  
15 **specific tangible benefits.**

16 A. My recommended additional conditions and tightening up of the conditions proposed by  
17 Joint Applicants include these additions to the conditions proposed by the Joint  
18 Applicants:

- 19 • Fortis and UNS Energy agree to provide economic customer benefit adjustments  
20 totaling \$59 million.<sup>1</sup> These benefits will include both immediate and long term  
21 benefits. RUCO is still working on defining these benefits and will either supplement  
22 this testimony or provide details of the nature of the benefits in its surrebuttal case.  
23 This amount is based on UNS being larger than Central Hudson and Central Hudson  
24 received the equivalent of \$49 million in customer benefits.
- 25 • In the event that Fortis completes any additional mergers or acquisitions within the  
26 United States before the Commission adopts an order approving new base rates for  
27 TEP, Fortis must share the follow-on merger savings that are reasonably applicable

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<sup>1</sup> This compares with \$44.25 million (\$9.25 million plus \$35 million) of ratepayer benefits guaranteed by Fortis in its acquisition of the Central Hudson utilities in New York, and \$5 million for a Community Benefit Fund for economic development and low income purposes for that Central Hudson acquisition. See, e.g., RUCO Fortis 1.04 Attachment A, UNS (0011) 001819-1820, included in Attachment RCS-5.

1 to TEP, UNS Electric and UNS Gas and their customers between shareholders and  
2 ratepayers, on a 50/50 basis, to the extent the portions of such savings realized by  
3 Fortis are material (i.e., 5 percent or more of TEP, UNS Electric and UNS Gas net  
4 income on an after-tax basis). UNS Energy must submit, within 90 days of the  
5 follow-on merger closing, a comprehensive and detailed proposal to share the follow-  
6 on merger savings, to begin on the closing date of the follow-on merger. In addition,  
7 the proposal must include an allocation method for sharing the synergy savings and  
8 efficiency gains among corporate entities that addresses the time period from the  
9 receipt of the synergy savings by TEP, UNS Electric and UNS Gas until the  
10 Commission approves new rates. The ratepayer share shall be set aside in a deferral  
11 account for future Commission disposition.<sup>2</sup>

- 12 • Fortis and UNS Energy agree and commit that none of the shareholder litigation costs  
13 shall be borne by the ratepayers of TEP, UNS Electric or UNS Gas.<sup>3</sup>
- 14 • Fortis and UNS Energy agree and commit that all Change of Control costs and  
15 Retention Bonus costs are transaction costs and none of those costs shall be borne by  
16 the ratepayers of TEP, UNS Electric or UNS Gas.<sup>4</sup> None of the transaction costs  
17 related to this acquisition and merger shall be borne by the ratepayers of TEP, UNS  
18 Electric or UNS Gas.
- 19 • Fortis and UNS Energy agree and commit that all benefits of the plans to sell coal to  
20 third parties for treatment to generate Internal Revenue Code §45 credits and to buy-  
21 back treated coal for burn at Springerville 1 and 2 (and at any other TEP coal-fired  
22 generating plants where such arrangements are established) will be passed onto TEP  
23 ratepayers through the PPFAC as described in the response to RUCO UNS 2.07.<sup>5</sup>
- 24 • Fortis and UNS Energy shall report to the Commission within five business days any  
25 changes in the credit ratings of Fortis, Inc., UNS Energy, TEP, UNS Electric or UNS  
26 Gas.

27  
28 **Q. Does your testimony address the ultimate question of whether the proposed**  
29 **transaction is in the public interest?**

30 **A. No. RUCO witness Lon Huber is presenting RUCO's position concerning whether the**  
31 **proposed transaction is in the public interest.**  
32

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<sup>2</sup> This is similar to the provision for Follow-On Merger Savings that Fortis committed to in its acquisition of the Central Hudson utilities in New York. See, e.g., RUCO Fortis 1.04 Attachment A, page UNS (0011) 001816, included in Attachment RCS-5.

<sup>3</sup> See, e.g., Response to RUCO Fortis 2.09, a copy of which is included in Attachment RCS-5.

<sup>4</sup> See, e.g., Responses to RUCO Fortis 2.32, 2.11 and 2.02 and RUCO UNS 1.04, copies of which is included in Attachment RCS-6.

<sup>5</sup> A copy of the response to RUCO UNS 2.07 is included in Attachment RCS-5.

1 **III. OVERVIEW OF THE PROPOSED ACQUISITION AND MERGER**

2 **Q. Please provide a brief overview of the proposed acquisition and merger.**

3 A. UNS Energy Corporation ("UNS Energy"), pursuant to A.A.C. R14-2-803, on behalf of  
4 itself and its affiliates UniSource Energy Services ("UES"), Tucson Electric Power  
5 Company ("TEP"), UNS Electric, Inc. ("UNS Electric" or "UNSE") and UNS Gas, Inc.  
6 ("UNS Gas" or "UNSG") (TEP, UNS Electric and UNS Gas are referred to collectively as  
7 the "Arizona Utilities"), and Fortis Inc. ("Fortis"), on behalf of itself and its affiliates,  
8 FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia"), a wholly owned  
9 subsidiary of Fortis, FortisUS Inc. ("FortisUS"), a wholly-owned subsidiary of FortisUS  
10 Nova Scotia, and Color Acquisition Sub Inc. ("Color Acquisition"), a wholly-owned  
11 subsidiary of FortisUS, have submitted in this docket their Joint Notice of Intent to  
12 Reorganize. On December 11, 2013, UNS Energy, Fortis, FortisUS and Color Acquisition  
13 entered into an Agreement and Plan of Merger ("Merger Agreement") as described UNS  
14 Energy's December 12, 2013 Form 8-K, and the related Merger Agreement. Pursuant to  
15 the Merger Agreement, and subject to various conditions such as shareholder and  
16 regulatory approvals, including approval by the Arizona Corporation Commission  
17 ("Commission"), Color Acquisition will merge with UNS Energy. UNS Energy will be the  
18 surviving entity, becoming a wholly-owned subsidiary of FortisUS with Fortis as its  
19 ultimate parent. In effect, UNS Energy's existing shareholders will be replaced by  
20 FortisUS as the sole shareholder. Direct ownership of UNS Energy's affiliates, including  
21 the Arizona Utilities, will remain at UNS Energy and thus, will not be changed by the  
22 merger.

23  
24 **Q. What benefits are claimed by the Joint Applicants?**

25 A. Pages 7-8 of the Joint Application claim the following benefits:

26 In light of the increasing challenges that face all electric utilities and will  
27 prove particularly daunting for smaller companies, UNS Energy and Fortis

1 believe that the merger will produce important benefits for the Arizona  
2 Utilities' customers, their employees and the communities they serve.  
3 Those benefits include, but are not limited to, the following:

4 (i) The ability to continue to provide safe, reliable and adequate  
5 service. The merger will financially strengthen UNS Energy and the  
6 Arizona Utilities so as to enhance their ability to provide safe and reliable  
7 service, especially in an increasingly challenging and capital intensive  
8 environment.

9 (ii) Infusion of equity capital into Arizona entities. Upon closing of the  
10 merger, Fortis has agreed to immediately inject \$200 million of equity  
11 capital into UNS Energy for the benefit of UNS Energy and the Arizona  
12 Utilities, thereby further strengthening their financial position.

13 On an on-going basis and consistent with established utility regulation, it is  
14 the practice of Fortis to inject equity into its regulated utility subsidiaries,  
15 when required, to maintain a capital structure consistent with that which is  
16 reflected in the regulated utility's customer rates and to support the  
17 regulated utility's credit ratings.

18 (iii) Improved access to the capital markets on fair and reasonable  
19 terms. UNS Energy and Fortis believe that Fortis' financial status and  
20 access to capital markets will improve the Arizona Utilities' ability to  
21 obtain sufficient capital to meet their needs. For example, any credit rating  
22 improvements should result in better access to debt capital at lower cost.

23 (iv) The commitment to continue the current union contracts,  
24 employee levels and employee benefits. As described in Part III below,  
25 the parties have committed to maintain existing employee levels at the  
26 Arizona Utilities and employee benefits for a period of at least two years  
27 after the conclusion of the merger. Moreover, the parties will continue to  
28 perform under the existing collective bargaining agreements for the  
29 Arizona Utilities. All future decisions on staffing, employment practices  
30 and labor relations at the Arizona Utilities will continue to be made by  
31 local management of the Arizona Utilities.

32 (v) The commitment to keep UNS Energy an Arizona-based and  
33 operated company. The parties have committed to retain UNS Energy's  
34 senior management, to maintain UNS Energy's headquarters in Tucson,  
35 Arizona, and to sustain UNS Energy's contributions to charitable and  
36 community programs. The parties also have committed to retain four  
37 members of the existing UNS Energy board of directors who are acceptable  
38 to FortisUS at the time of closing the merger, provided that one such  
39 designee shall be UNS Energy's Chief Executive Officer. In addition, as  
40 described in Part III below, no later than one year after closing of the  
41 merger, FortisUS shall have appointed a board of directors for UNS Energy  
42 and the Arizona Utilities, the majority of whom will be independent, with  
43 the majority of such independent directors being residents of the State of

1 Arizona, and with emphasis on selecting candidates who reside, conduct  
2 business or work within the Arizona Utilities' service territories.

3 **Q. Are the first three claimed benefits all related to a claim by Joint Applicants that the**  
4 **financial strength would be improved?**

5 **A.** Essentially, yes.  
6

7 **Q. Is it guaranteed that the Arizona Utilities' financial strength would improve under**  
8 **Fortis' ownership?**

9 **A.** No. The Arizona Utilities have exhibited the ability to obtain sufficient capital to meet  
10 their needs in recent years, and have improved their capital structure and bond ratings  
11 without needing to be acquired. Additionally, while any credit rating improvements  
12 should result in better access to debt capital at lower cost, there is also no guarantee that  
13 credit ratings would improve under Fortis' ownership. The claim that the Arizona  
14 Utilities' financial strength would improve is an expectation not a guarantee.  
15

16 **Q. The second claimed benefit is that Fortis would inject \$200 million of equity into**  
17 **UNS Energy, and would employ the practice of Fortis to inject equity into its**  
18 **regulated utility subsidiaries, when required, to maintain a capital structure**  
19 **consistent with that which is reflected in the regulated utility's customer rates and to**  
20 **support the regulated utility's credit ratings. Is that a benefit?**

21 **A.** Yes, however, the benefit of the \$200 million of Fortis equity injection needs to be viewed  
22 in context, and balanced with the risks of creating a very large amount of Goodwill that  
23 would result from the transaction.<sup>6</sup> Goodwill represents the excess, at the dates of  
24 acquisition, of the purchase price over the fair value of the net tangible and identifiable  
25 intangible assets acquired and liabilities assumed relating to business acquisitions.

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<sup>6</sup>Estimated Goodwill provided in response to data request RUCO Fortis 2.05 is US \$1.407 billion (C \$1.496 billion). The initial Goodwill amount is therefore approximately seven times the size of the initial Fortis equity injection of \$200 million noted above.



1 Goodwill is carried at initial cost less any write-down for impairment. Goodwill is  
2 basically an intangible asset that arises as a result of the acquisition of one company by  
3 another for a premium value. Goodwill is usually recorded on the acquiring company's  
4 balance sheet and is considered an intangible asset because it is not a physical asset like  
5 buildings or equipment. The equity injection amount is relatively small compared to the  
6 amount of Goodwill that Fortis is projected to record as a result of the acquisition.  
7 Additionally, the injection of \$200 million may be returned to Fortis in the form of  
8 dividends and inter-company interest within a relatively short time frame after assuming  
9 ownership, such as 2.5 to 3 years. Also, it appears that [BEGIN CONFIDENTIAL] [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]<sup>7</sup> [END CONFIDENTIAL]

13  
14 Q. In recent years has UNS Energy been able to maintain a capital structure for the  
15 Arizona Utilities which supported their credit ratings?

16 A. Yes. As reflected in the most recent rate applications of TEP, UNS Electric and UNS Gas  
17 a capital structure consistent with that which is reflected in the regulated utility's customer  
18 rates has been used, and those capital structures have supported the regulated utility's  
19 credit ratings. That has been done without having foreign ownership.

20  
21 Q. Can the creation of a large amount of Goodwill present risks even if there is not an  
22 attempt to recover the Goodwill directly from ratepayers?

23 A. Yes. Large amounts of Goodwill which are intangibles assets that do not earn a return and  
24 which are not amortized can present a challenge for the acquiring company's management  
25 in a number of respects. Goodwill is not used or useful in the provision of utility service.

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<sup>7</sup> [BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED] [END CONFIDENTIAL]

1 Having large amounts of such assets on the books also requires the acquiring company to  
2 finance those assets by having long term capital sources such as debt and equity on the  
3 liabilities and shareholder equity side of its balance sheet. Having large amounts of non-  
4 earning assets on a company's balance can put pressure on earnings per share. Goodwill is  
5 also subject to periodic impairment testing. Impairments of Goodwill can result in large  
6 losses and can lead to reductions to recorded amounts of equity capital.<sup>8</sup> I discuss the  
7 Joint Applicants proposed safeguards relating to Goodwill in additional detail in a  
8 subsequent section of my testimony.

9  
10 **Q. Are the fourth and fifth items benefits that would result from the proposed**  
11 **transaction?**

12 **A.** No. Without the proposed acquisition, there is no indication that UNS Energy would fail  
13 to maintain existing employee levels at the Arizona Utilities and employee benefits for a  
14 period of at least two years, or honor existing union contracts, or have Arizona-based  
15 management making decisions about staffing. Additionally, there is no indication that  
16 without the proposed acquisition, UNS Energy's senior management would fail to be  
17 maintained, UNS Energy's headquarters would not be maintained in Tucson, Arizona, or  
18 that UNS Energy's contributions to charitable and community programs would not be  
19 sustained. Consequently, these items are more the nature of maintaining the status quo  
20 that would exist without the proposed transaction.

21  
22 **Q. Are there risks that Fortis' access to long term capital at reasonable costs could be**  
23 **impaired?**

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<sup>8</sup> As some illustrative examples, Qwest recognized a Goodwill impairment loss of approximately \$41 billion subsequent to acquiring U.S. West. AOL had a Goodwill impairment loss of approximately \$54 billion after acquiring Time Warner. Other companies which have acquired utilities, such as Scottish Power which had acquired PacifiCorp and Thames Water which had acquired American Water Works, have also experienced substantial amounts of Goodwill impairment write-downs subsequent to those acquisitions.

1 A. Yes. For example, as described at page 47 of the Fortis Inc. 2013 Annual Report:

2 The Corporation's financial position could be adversely affected if it and/or  
3 its larger subsidiaries fail to arrange sufficient and cost-effective financing  
4 to fund, among other things, capital expenditures and the repayment of  
5 maturing debt. The ability to arrange sufficient and cost-effective financing  
6 is subject to numerous factors, including the results of operations and  
7 financial position of the Corporation and its subsidiaries; the regulatory  
8 environment in which the utilities operate and the nature and outcome of  
9 regulatory decisions regarding capital structure and allowed ROEs;  
10 conditions in the capital and bank credit markets; ratings assigned by credit  
11 rating agencies; and general economic conditions. Funds generated from  
12 operations after payment of expected expenses, including interest payments  
13 on any outstanding debt, may not be sufficient to fund the repayment of all  
14 outstanding liabilities when due and anticipated capital expenditures. There  
15 can be no assurance that sufficient capital will continue to be available on  
16 acceptable terms to fund capital expenditures and repay existing debt.

17  
18 Q. Is Fortis also subject to foreign currency risks in a way that UNS Energy currently is  
19 not?

20 A. Yes. Fluctuations in exchange rates between the Canadian Dollar and other currencies are  
21 a risk affecting Fortis. Fluctuations in the exchange rate between the U.S. and Canadian  
22 dollar will have a more significant impact on Fortis if the proposed transaction is  
23 consummated. The acquisition of UNS Energy will heighten the degree of exchange rate  
24 risk. As described on page 45 of the Fortis, Inc., 2013 Annual Report:

25 Fortis is exposed to foreign exchange risk associated with the acquisition of  
26 UNS Energy as the cash consideration for the acquisition is required to be  
27 paid in US dollars, while funds raised in the Debenture offering, which will  
28 constitute a significant portion of the funds used to finance the acquisition,  
29 are denominated in Canadian dollars. As a result, increases in the US  
30 dollar-to-Canadian dollar exchange rate prior to payment of the Final  
31 Installment will increase the purchase price translated in Canadian dollars,  
32 and thereby reduce the proportion of the purchase price for the acquisition  
33 ultimately obtained by Fortis under the Debenture offering. In addition, the  
34 operations of UNS Energy are conducted in US dollars and, following the  
35 acquisition, the consolidated earnings and cash flows of Fortis will be  
36 impacted to a greater extent by fluctuations in the US dollar-to-Canadian  
37 dollar exchange rate.

1     **Q.     What cost savings are anticipated as a result of the proposed transaction?**

2     A.     The response to UDR 1.36 states that anticipated cost savings include reduced or  
3           eliminated public company costs, reduced insurance costs, and a potentially lower cost of  
4           debt as the result of anticipated credit rating upgrades.

5  
6     **Omissions from Presentation of Post-Merger Corporate Organizational Structure**

7     **Q.     Were organizational charts provided by the Joint Applicants?**

8     A.     Yes. Joint Applicants provided pre-merger and post-merger corporate organizational  
9           charts in Exhibit 2 to their application. Those corporate organizational charts are  
10          reproduced for ease of reference in Attachment RCS-2.

11  
12    **Q.     Do the organizational charts presented by Joint Applicants appear to provide a**  
13          **complete depiction of the post-merger corporate structuring including disclosure of**  
14          **the Fortis subsidiaries that are proposed to be used to finance the acquisition?**

15    A.     No. Attachment RCS-3 shows a corporate organizational chart for Fortis, Inc. as of  
16          February 2014. Shown on that Fortis, Inc. organizational chart is an entity,  
17          NewfoundlandEnergy Luxembourg S.à.r.l ("Luxembourg" or "Luxembourg conduit") that  
18          appears to be a key component in the financing arrangement being used by Fortis;  
19          however, there is no disclosure of this Luxembourg conduit entity or its role in the  
20          financing arrangement in Exhibit 2 in the Joint Application (or anywhere else in the Joint  
21          Application or in Joint Applicant's testimony).

22  
23    **IV.     STANDARD OF REVIEW**

24    **Q.     Where do the Joint Applicants recognize that their proposed merger is subject to the**  
25          **approval of the Arizona Corporation Commission?**

1 A. The Applicants' "Joint Notice of Proposed Merger" requests that the Commission issue an  
2 order approving the merger. In that Joint Notice, Applicants recognize that, pursuant to  
3 A.A.C. R14-2-803, their proposed merger is subject to the Commission's approval.

4  
5 **Q. What does A.A.C. R14-2-803(C) state regarding the Commission approval or**  
6 **rejection of a notice of intent to reorganize?**

7 A. A.A.C. R14-2-803(C) states that: "At the conclusion of any hearing on the organization or  
8 reorganization of a utility holding company, the Commission may reject the proposal if it  
9 determines that it would impair the financial status of the public utility, otherwise prevent  
10 it from attracting capital at fair and reasonable terms, or impair the ability of the public  
11 utility to provide safe, reasonable and adequate service."

12  
13 **Q. Is the Standard of Review for a proposed merger limited to the statements in A.A.C.**  
14 **R14-2-803(C)?**

15 A. This is obviously a legal matter for the Commission to determine; however, the  
16 Commission has previously concluded in its January 4, 2005 Decision No. 67454 in  
17 Docket No. E-04230A-03-0933<sup>9</sup> at page 49 that:

18 5. Pursuant to the Arizona Constitution and A.R. S. Title 40 generally, the  
19 Commission is required to act in the "public interest" and must consider all  
20 of the evidence available in determining the "public interest".

21 6. The public interest requires that the Commission apply the Affiliated  
22 Interest Rues in a manner that will maximize protection to ratepayers.

23 7. Utility ratepayers should not be required to bear the burden of risk  
24 resulting from holding company structure or diversification.

25 8. The factors set out in A.A.C. R14-2-803(C) are only a part of the "public  
26 interest" inquiry that the Commission must make as part of its  
27 consideration of the proposed transaction.

28

---

<sup>9</sup> UniSource Energy's previous attempt to sell itself which was unsuccessful and will be discussed in more detail below.

1     **Q.     Is additional guidance on the Standard of Review provided in Decision No. 67454?**

2     **A.     Yes. The following discussion is presented at pages 20-21 of Decision No. 67454:**

3  
4             Standard of Review

5             Staff states that the Arizona Constitution vests the Commission with a duty  
6             to consider and act in the interest of the public. Article 15 § 3 of the  
7             Constitution gives the Commission the power "to make and enforce  
8             reasonable rules, regulations, and orders for the convenience, comfort, and  
9             safety, and the preservation of the health, of the employees and patrons of  
10            [public service corporations]." Staff asserts the Commission must not only  
11            consider, but act, in the public interest. *James P. Paul Water Co. v Arizona*  
12            *Corporation Commission*, 137 Ariz. 426, 429, 671 P.2d 404, 407 (1983)  
13            and *Arizona Corporation Commission v. Woods*, 171 Ariz. 286, 296, 830  
14            P.2d 807, 818 (1992). Further, determining the public interest involves a  
15            broad consideration of all the evidence presented. *Pueblo Del Sol Water*  
16            *Co. v. Arizona Corporation Commission*, 160 Ariz. 285, 286, 772 P.2d  
17            1138, 1139 (App. 1989).

18            Staff asserts that as part of its public interest analysis, the Commission may  
19            appropriately consider all applicable statutes and rules, which in the matter  
20            at hand includes A.A.C. R14-2-803 of the Affiliated Interest Rules. Staff  
21            argues, however, that this Rule does not limit the Commission's review to  
22            the three listed factors in subsection (C). Staff suggests that an appropriate  
23            view of the Rule is one that considers the language set forth in subsection  
24            (C) as examples of when this type of transaction can be found to be not in  
25            the public interest.

26            Considering the great deference courts have granted the Commission  
27            pursuant to its ratemaking authority, coupled with clear authority over  
28            "Affiliated Interest" matters, Staff argues the Commission must be free to  
29            act in the furtherance of its constitutional duty. Staff argues it would be  
30            counter to that duty for the Commission to construct a rule that would act  
31            to obstruct the broad constitutional duty to take any action necessary in the  
32            furtherance of proper ratemaking. Thus, Staff advances, Rule 803(C) must  
33            be interpreted consistent with the Constitution, and to interpret Rule 803(C)  
34            as a limit on the review of the public interest would obstruct the  
35            Commission's constitutional duty. Staff questions whether an interpretation  
36            of Rule 803(C) that would limit the "public interest" to the three areas  
37            spelled out would render the Commission powerless to protect against a  
38            merger that could potentially harm the health or safety of Arizonans if the  
39            harm was not directly tied to the regulated utilities' provision of service.  
40            Staff asserts Rule 803 is designed to highlight particularly problematic  
41            areas that the Commission should include in its consideration of the public  
42            interest.

Staff further notes that in Decision No. 56844 (March 14, 1990), the Decision adopting the Affiliated Interest Rules, the Commission made no indication that these rules were intended to supersede or replace the Commission's constitutional charge. Decision No. 56844 states the Affiliated Interest Rules are "designed to insure that utility ratepayers are insulated from the dangers proven to be inherent in holding structure and diversification." (Attachment B, at 2) The Decision provides that the Rules' purpose is to provide specific additional protections to ratepayers, which demonstrate the Commission's intent that they enhance, rather than limit, the public interest analysis.

Staff submits that without conditions, the Application clearly fails AAC R14-2-803(C) and is not in the public interest. Staff believes its proposed conditions, as set forth in Exhibit C attached hereto, are necessary to mitigate potential detriments from the proposed Merger. Even with its recommended conditions, Staff was unable to identify any benefits to consumers from the proposed Merger.

Staff states that benefits are not inherent requirements for finding a transaction in the public interest, but that in this matter there are so many potential risks and unknowns, that without benefits it is difficult for Staff to state that the matter is in the public interest. Even with the adoption of all of Staff's recommended conditions, in the absence of benefits to customers, Staff is neutral regarding approval of the transaction.

**Q. What do you conclude from this guidance?**

A. I conclude that the Standard for Review is to examine whether a proposed transaction is in the "public interest" and the Commission's review must consider all of the evidence available in determining the "public interest" and apply the Affiliated Interest Rules in a manner that will maximize protection to ratepayers.

**V. PREVIOUS ATTEMPT TO SELL UNISOURCE ENERGY**

**Q. Does the present application represent the first attempt to sell UniSource Energy in recent years?**

A. No. In 2004, in Docket No. E-04230A-03-0933, a proposed sale of UniSource Energy to Saguaro Acquisition Corporation ("Saguaro") was presented to the Commission for approval. The proposed Saguaro acquisition involved a consortium of investment firms,

1 including KKR, J.P. Morgan Partners ("JPMP") and Wachovia Capital Partners ("WCP"),  
2 and was purported to provide a tangible benefit to Arizona ratepayers.  
3

4 **Q. Was that application to sell UniSource Energy approved by the Commission?**

5 A. No, it was not. In 2004, the Commission denied the proposed merger of UniSource  
6 Energy, after determining that the risks of that proposed transaction outweighed the  
7 proposed benefits, and concluding that proposed transaction was not in the public interest.  
8

9 **Q. Was a subsequent acquisition consummated by a leveraged buyout group of another**  
10 **utility operating in the Southwest U.S.?**

11 A. Yes. An investment group including KKR and others acquired the Texas electric utility  
12 formerly known as TXU Energy in 2007. Under the new ownership, the company was  
13 renamed Energy Future Holdings Corp. ("EFH").  
14

15 **Q. What are the electric industry components of EFH, and which are regulated public**  
16 **utilities?**

17 A. EFH is the largest power-plant owner in Texas. Its units include Oncor Electric Delivery  
18 Co. ("Oncor"), the regulated business that delivers electricity to more than 3 million  
19 homes and businesses; TXU Energy, a retail electricity seller; and Luminant, which owns  
20 more than 15,400 megawatts of generation capacity in Texas.  
21

22 **Q. Has that acquisition subsequently run into difficulties?**

23 A. Yes. As reported in recent news articles<sup>10</sup>, Energy Future appears to be marching toward  
24 the largest leveraged-buyout bankruptcy in history and is in jeopardy of deteriorating into  
25 a free-for-all among Wall Street titans ranging from KKR & Co. to Centerbridge Capital

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<sup>10</sup> See, e.g., illustrative recent news articles, included in Attachment RCS-4.



Partners LP and Apollo Global Management LLC. Doubts have been raised about Energy Future's ability to remain a going concern, which could trigger a default on approximately \$45 billion of debt. As noted in recent news articles<sup>11</sup>:

The clock is ticking for Dallas-based EFH because the company skipped a \$109 million interest payment that was due April 1, giving the company until April 30 to reach a pre-packaged bankruptcy or face the wrath of scorned creditors.<sup>12</sup>

...

KKR, Goldman Sachs Capital Partners and TPG Capital bought out the former TXU Corp. in 2007 with tens of billions in borrowed dollars, hoping that the deregulated electricity market, high power prices and steady growth would prove a winning investment. But falling natural gas prices led to lower electricity prices, eroding EFH's ability to generate enough money to pay down the loans.

It now owes about \$45 billion in debt. EFH owns about 80 percent of Oncor, having sold the rest shortly after the buyout to raise cash.

...

EFH, now in a 30-day grace period of a missed interest payment that was due April 1, is widely expected to file a Chapter 11 bankruptcy petition this month.<sup>13</sup>

**Q. Do you think that the proposed Fortis acquisition of UNS Energy represents the same risks as the previously proposed KKR-led buyout of UNS Energy which was rejected by the Commission in 2004, or of the KKR-led acquisition of EFH?**

**A.** No. The subsequent events related to the KKR-led acquisition of EFH highlight some of the risks related to a large acquisition, including the dangers of using excessive debt leverage in the transaction. The generation business of EFH operates in a deregulated/competitive market, unlike the Arizona electric utilities of UNS Energy, each of which have cost-based base rates, which include the costs related to electric generation plant. The proposed Fortis acquisition of UNS Energy is not being structured as a

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<sup>11</sup> Id.

<sup>12</sup> Apr. 17, 2014, Star-Telegram.

<sup>13</sup> Apr 14, 2014, Dallas Business Journal, Morning Edition.

1 leveraged buyout. Fortis has proposed to utilize a financing arrangement which appears to  
2 be less leveraged and more conducive to financing a regulated utility operation, although  
3 there are some concerns, which I will articulate in additional detail in a subsequent section  
4 of my testimony, about Fortis' intended use of inter-company debt and a Luxembourg  
5 conduit entity as part of its anticipated financing. In view of the serious financial  
6 problems developing at EFH after its leveraged buyout, the Commission's rejection of the  
7 previously proposed attempt to sell UNS Energy, which helped avoid such problems from  
8 affecting UNS Energy and its Arizona utilities, certainly appears to have protected the  
9 public interest.

10  
11 **VI. FORTIS' ACQUISITION OF OTHER U.S. UTILITIES**

12 **Q. Is the proposed acquisition of UNS Energy by Fortis the first attempted acquisition**  
13 **of a regulated utility in the United States by Fortis?**

14 **A.** No. The proposed acquisition of UNS Energy appears to be the third attempted  
15 acquisition of a regulated utility (or its holding company) located in the United States by  
16 Fortis.

17 In 2012, Fortis attempted to acquire Central Vermont Public Service Corporation;  
18 however, that acquisition attempt by Fortis was ultimately unsuccessful.<sup>14</sup>

19 In 2013, Fortis was successful in acquiring CH Energy, the holding company for  
20 Central Hudson Gas & Electric Corporation ("Central Hudson"), a gas and electric utility  
21 serving approximately 376,000 customers in New York State.

22  
23 **Q. Have you reviewed some of the materials related to Fortis' acquisition of Central**  
24 **Hudson?**

---

<sup>14</sup> Central Vermont was ultimately acquired by another company, Gaz Metro, and was subsequently merged with another Vermont electric utility, Green Mountain Power Company.

1 A. Yes. I reviewed some of the publicly available materials related to Fortis' acquisition of  
2 CH Energy, including the New York Public Service Commission's orders dated June 26,  
3 2013 and November 26, 2013 in NYPSC Case No. 12-M-0192, which address that  
4 acquisition and merger.

5  
6 **Q. Were provisions to protect ratepayers from harm and for providing specific tangible**  
7 **benefits to ratepayers imposed upon Fortis' acquisition of CH Energy?**

8 A. Yes. A copy of the portions of the NYPSC Order in Case No. 12-M-0192 listing the  
9 conditions that were imposed upon Fortis' acquisition of CH Energy is presented in  
10 Appendix RCS-5.

11  
12 **Q. What specific conditions to provide for specific tangible ratepayer benefits were**  
13 **provided for in that acquisition?**

14 A. As shown in the response to RUCO Fortis 1.04 Attachment A (a copy of which is included  
15 in Attachment RCS-5) the Central Hudson conditions included the following specific  
16 tangible ratepayer benefits:

17 10. Economic Benefits, Including Synergies and Positive Benefit  
18 Adjustments

19 Fortis and Central Hudson have agreed to provide quantified economic  
20 benefits comprised of the following synergy and positive benefit  
21 adjustments: (i) synergy savings which are guaranteed for a period of 5  
22 years and which will provide for future rate mitigation of \$9.25 million  
23 over the 5 years; (ii) a total of \$35 million of combined write-offs of  
24 deferred regulatory assets and future rate mitigation funds; and, (iii) one-  
25 time funding of \$5 million for a Community Benefit Fund for economic  
26 development and low income purposes.

27 a) Synergy Savings/Guaranteed Rate Reductions

28 The Signatories have agreed that the transaction will produce synergy  
29 savings/guaranteed future rate mitigation totaling \$9.25 million (\$1.85  
30 million/year for 5 years). Petitioners have agreed to guarantee these cost  
31 savings for a period of five years, and will begin accruing these guaranteed  
32 cost savings in the month following closing. The Signatories recognize that

1 this accrual will provide rate mitigation for the benefit of customers that  
2 will be available at the start of the first rate year in the next rate case filed  
3 by Central Hudson. The Signatories anticipate that the forecast effect of the  
4 synergy cost savings will also be reflected in rates in Central Hudson's next  
5 rate case.

6 b) Deferred Storm Restoration Cost Write-offs and Future Rate Mitigation

7 A total of \$35 million will be provided to Central Hudson by Fortis upon  
8 the closing of the transaction and will be recorded as a regulatory liability  
9 to be applied to write off regulatory assets on the books of Central Hudson  
10 due to storm restoration costs and to provide balance sheet offsets and rate  
11 mitigation in Central Hudson's next rate filing.

12 i) Storm Restoration Cost Write-offs

13 Central Hudson currently has two storm restoration cost deferral petitions  
14 pending before the Commission in Cases 11-E-0651 (\$11.0 million  
15 exclusive of carrying charges) and 12-M-0204 (\$1.6 million exclusive of  
16 carrying charges) , for a total of \$12.6 million exclusive of carrying  
17 charges. Additionally, Central Hudson has estimated that the incremental  
18 storm restoration costs above the current rate allowance resulting from  
19 Super-storm Sandy will be approximately \$10 million. The Signatories  
20 agree that Central Hudson shall file a formal Super-storm Sandy deferral  
21 petition as soon as reasonably practicable.

22 The Signatories agree to utilize a placeholder total for these three events of  
23 \$22 million. The Signatories agree that \$22 million will be written off  
24 promptly after the closing against the \$35 million regulatory liability being  
25 funded by Fortis, subject to true-up for subsequent Commission  
26 determinations concerning the storm restoration costs of the three storms.  
27 The Signatories agree that the three deferral requests will be reviewed by  
28 Staff consistent with the principles and practices in the recent Central  
29 Hudson storm restoration deferral petitions involving Twin Peaks  
30 (February 2010) in Case 10-M-0473 and the December 2008 ice storm in  
31 Case 09-M-0004.

32 ii) Disposition of the Remaining Balance

33 The difference between the \$35 million being provided by Fortis and the  
34 \$22 million in placeholder storm restoration cost write-offs is currently  
35 estimated as a \$13 million placeholder. The Signatories agree that this \$13  
36 million difference will be reserved as a regulatory liability with carrying  
37 charges at the pre-tax rate of return rate. At the time of the final, true-up  
38 storm restoration cost determination by the Commission, the reserve and  
39 associated carrying charges will be adjusted up or down to conform to the  
40 Commission's determination. The final amount will be reserved for  
41 additional future balance sheet write-offs or other rate moderation  
42 purposes, as shall be determined in Central Hudson's next rate case.

1 c) Community Benefit Fund

2 A total of \$5 million will be provided by Fortis for a Community Benefit  
3 Fund to be utilized for low income and economic development purposes as  
4 discussed in greater detail previously in this Joint Proposal.

5  
6 **Q. If and after it acquires UNS Energy, does Fortis intend to continue to seek other**  
7 **acquisitions of utilities in the United States or elsewhere?**

8 **A.** This question was posed to Fortis in RUCO Fortis 2.08. Fortis' response states that:

9 Fortis will continue to assess acquisition opportunities in Canada and the  
10 United States that may arise from time to time. These would be limited to  
11 regulated utilities and hydroelectric generation opportunities with long term  
12 contracts. Fortis currently does not intend to pursue opportunities outside  
13 these two countries.

14 Currently, Fortis is not assessing other acquisition opportunities and is  
15 focused on completing the acquisition of UNS Energy. In the near term,  
16 Fortis expects to focus on organic growth opportunities within its regulated  
17 utilities.

18  
19 **Q. Was a specific condition included in Fortis' acquisition of Central Hudson to address**  
20 **sharing of follow-on merger synergies?**

21 **A.** Yes. The Central Hudson conditions included the following provision for follow-on  
22 merger savings:

23 7. Follow-On Merger Savings

24 a) In the event that Fortis completes any additional mergers or acquisitions  
25 within the United States before the Commission adopts an order approving  
26 new rates for Central Hudson, Fortis must share the follow-on merger  
27 savings that are reasonably applicable to Central Hudson and its customers  
28 between shareholders and ratepayers, on a 50/50 basis, to the extent the  
29 portions of such savings realized by Fortis are material (i.e., 5 percent or  
30 more of Central Hudson net income on an after-tax basis). Central Hudson  
31 must submit, within 90 days of the follow-on merger closing, a  
32 comprehensive and detailed proposal to share the follow-on merger  
33 savings, to begin on the closing date of the follow-on merger. In addition,  
34 the proposal must include an allocation method for sharing the synergy  
35 savings and efficiency gains among corporate entities that addresses the  
36 time period from the receipt of the synergy savings by Central Hudson until

1 the Commission approves new rates. The ratepayer share shall be set aside  
2 in a deferral account for future Commission disposition.

3  
4 **Q. Are similar specific tangible ratepayer benefits reflected in the Joint Applicants'**  
5 **proposal filed to date?**

6 A. No. Tangible ratepayer benefits similar to those that were imposed upon Fortis'  
7 acquisition of CH Energy are lacking in the conditions that have been reflected in the Joint  
8 Applicants' proposal for Fortis to acquire UNS Energy in the Joint Applicant materials  
9 filed to date.

10  
11 **Q. Is there a similar need for conditions providing for specific tangible ratepayer**  
12 **benefits for Fortis' proposed acquisition of UNS Energy?**

13 A. I believe there is, in order to help mitigate risks that the transaction poses for Arizona  
14 ratepayers of the three utilities. As described above<sup>15</sup> my recommended additional  
15 conditions for approval of the proposed transaction includes the following conditions to  
16 provide for ratepayer benefits from the proposed transaction and, similar to the Central  
17 Hudson condition, for sharing of any follow-on merger synergies:

- 18 • Fortis and UNS Energy agree to provide economic customer benefit adjustments  
19 totaling \$59 million.<sup>16</sup> These benefits will include both immediate and long term  
20 benefits. This amount is based on UNS being larger than Central Hudson and Central  
21 Hudson received the equivalent of \$49 million in customer benefits.
- 22 • In the event that Fortis completes any additional mergers or acquisitions within the  
23 United States before the Commission adopts an order approving new base rates for  
24 TEP, Fortis must share the follow-on merger savings that are reasonably applicable  
25 to TEP, UNS Electric and UNS Gas and their customers between shareholders and  
26 ratepayers, on a 50/50 basis, to the extent the portions of such savings realized by  
27 Fortis are material (i.e., 5 percent or more of TEP, UNS Electric and UNS Gas net

<sup>15</sup> See, this testimony, section II. SUMMARY OF TESTIMONY AND CONCLUSIONS.

<sup>16</sup> This compares with \$44.25 million (\$9.25 million plus \$35 million) of ratepayer benefits guaranteed by Fortis in its acquisition of the Central Hudson utilities in New York, and \$5 million for a Community Benefit Fund for economic development and low income purposes for that Central Hudson acquisition. See, e.g., RUCO Fortis 1.04 Attachment A, UNS (0011) 001819-1820, included in Attachment RCS-5. As mentioned above, RUCO is still working on defining these benefits and will either supplement this testimony or provide details of the nature of the benefits in its surrebuttal case.

1 income on an after-tax basis). UNS Energy must submit, within 90 days of the  
2 follow-on merger closing, a comprehensive and detailed proposal to share the follow-  
3 on merger savings, to begin on the closing date of the follow-on merger. In addition,  
4 the proposal must include an allocation method for sharing the synergy savings and  
5 efficiency gains among corporate entities that addresses the time period from the  
6 receipt of the synergy savings by TEP, UNS Electric and UNS Gas until the  
7 Commission approves new rates. The ratepayer share shall be set aside in a deferral  
8 account for future Commission disposition.<sup>17</sup>

9  
10 I discuss in additional detail in a subsequent section of my testimony,<sup>18</sup> one potential  
11 source to fund these benefits could be based on a sharing of estimated Fortis, Inc. earnings  
12 accretion for 2015-2018 related to the Luxembourg conduit and affiliated debt  
13 arrangement that Fortis plans to use for this transaction for financing and repatriation of  
14 dividends.

15  
16 **VII. GOODWILL/ ACQUISITION ADJUSTMENT / TRANSACTION COSTS**

17 **Goodwill**

18 **Q. Will the proposed acquisition result in the recording of Goodwill?**

19 **A.** Yes. It appears that it will in a substantial amount.

20  
21 **Q. Approximately what amount of Goodwill would be recorded?**

22 **A.** Approximately \$1.407 billion.<sup>19</sup>

23  
24 **Q. On which entity's books would the Goodwill be recorded?**

---

<sup>17</sup> This is similar to the provision for Follow-On Merger Savings that Fortis committed to in its acquisition of the Central Hudson utilities in New York. See, e.g., RUCO Fortis 1.04 Attachment A, page UNS (0011) 001816, included in Attachment RCS-5.

<sup>18</sup> See, e.g., this testimony at section XII, I. LUXEMBOURG CONDUIT / INTER-COMPANY DEBT FINANCING / IMPACT ON FORTIS' ANTICIPATED EARNINGS ACCRETION.

<sup>19</sup> See, Data response to RUCO Fortis 2.05(a).

1 A. As proposed by the Joint Applicants, an attempt would be made to avoid having to record  
2 any Goodwill resulting from the transaction on the books of any of the Arizona utilities.  
3 However, there appears to be some uncertainty as to whether U.S. generally accepted  
4 accounting principles ("GAAP") would allow the acquired company to avoid "push down"  
5 accounting, i.e., to avoid having to record Goodwill (or some equivalent to Goodwill, such  
6 as an Acquisition Adjustment) on the books of the Arizona utilities.<sup>20</sup>

7  
8 **Q. Have the Joint Applicant's offered conditions to protect Arizona utility ratepayers**  
9 **from the impact of Goodwill that is expected to result from the proposed**  
10 **transaction?**

11 A. Yes. Applicants propose the following conditions relating to Goodwill and transaction  
12 costs:

13 5. UNS Energy, the Arizona Utilities and FortisUS agree that the goodwill  
14 and transaction costs of this acquisition will be excluded from the rate base,  
15 expenses, and capitalization in the determination of rates and earned returns  
16 of the Arizona Utilities and for Arizona state regulatory accounting and  
17 reporting purposes.

18 6. To the extent permissible under U.S. Generally Accepted Accounting  
19 Principles ("U.S. GAAP"), no goodwill or transaction costs associated with  
20 this acquisition will be reflected on the books of the Arizona Utilities.  
21 Should U.S. GAAP, including any future accounting changes, require that  
22 the goodwill associated with the acquisition be "pushed down" and  
23 therefore reflected in the accounts of the Arizona Utilities, the goodwill  
24 will not be reflected in the regulated accounts of the Arizona Utilities for  
25 purposes of determining rate base, setting rates, establishing capital  
26 structure or other regulatory accounting and reporting purposes.

27 7. UNS Energy and the Arizona Utilities will prepare a final schedule of  
28 the external costs to achieve the merger following consummation of the  
29 transaction as a demonstration that there will be no recovery requested in  
30 the Arizona Utilities' rates, or recognition in the determination of rate base

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<sup>20</sup> Under the Uniform System of Accounts, Account 114, plant acquisition adjustments are based on the difference between (a) the cost to the accounting utility of gas plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated provisions for depreciation, depletion, and amortization and contributions in aid of construction with respect to such property.



1 of any legal or financial advisory fees, or other external costs associated  
2 with the FortisUS acquisition of UNS Energy, and indirectly, the Arizona  
3 Utilities.

4  
5 Additionally, Joint Applicants' response to UDR 1.37 confirms that, per stipulated  
6 condition No. 5 included in the Joint Notice of Intent to Reorganize, TEP, UNS Gas and  
7 UNS Electric will not seek rate recovery of any premium to be paid by Fortis for UNS  
8 Energy common stock or any transaction cost associated with the acquisition.

9  
10 **Q. Can you explain in general terms how a Goodwill impairment could occur?**

11 **A.** Yes. Generally, a Goodwill impairment occurs when a company (1) pays more than book  
12 value for a set of assets (the difference is the Goodwill), and (2) must later adjust the book  
13 value of that Goodwill.

14 Goodwill is an asset, but it does not amortize or depreciate like other assets.  
15 Instead, GAAP rules require companies to "test" Goodwill every year for impairments.

16 As a hypothetical illustration of a Goodwill impairment, let's assume that  
17 Company A purchases Company B. The book value of Company B's assets is \$3 billion,  
18 but for various reasons, Company A pays \$4.4 billion for Company B, including assumed  
19 debt. Because Company A paid \$4.4 billion for \$3 billion worth of assets, Company A  
20 records \$1.4 billion of Goodwill as an intangible asset on its balance sheet.

21 After the acquisition, Company B's actual sales growth or earnings come in lower  
22 than the projections that Company A was expecting when it evaluated the purchase. This  
23 could occur for a variety of reasons including changing economic conditions, changes in  
24 the regulatory environment, changes in competition from new technologies such a  
25 distributed generation or rooftop solar, lower authorized return on equity (ROE), etc. A  
26 Goodwill impairment could also occur if changing conditions in the stock or long-term  
27 debt markets result in lower valuations generally, such as if there were to be a sustained

1 rise in long term interest rates, which could result in higher discount rates being applied  
2 and lower net present values being assigned to future cash flow streams. Generally, all  
3 things being equal, the higher the interest rate used in a net present value calculation of a  
4 stream of estimated future cash flows, the lower the resultant NPV result.

5 In our hypothetical example, a few years have now passed, and for Company A,  
6 this means comparing a current estimate of the fair value of Company B to the book value  
7 on Company's A's financial statements. If the fair value of Company B is less than the  
8 book value (that is, if Company A were to sell Company B today, it wouldn't get a price  
9 equal to or greater than its recorded value), Company A must recognize a Goodwill  
10 impairment. The estimation of fair value involves a considerable degree of judgment, and  
11 therefore its application is subject to some discretion by Company A's management. A  
12 change in management at Company A could trigger a more stringent evaluation of  
13 Goodwill resulting from past acquisitions that are attributable to prior management that is  
14 no longer there. In this hypothetical example, assume that Company B's current estimated  
15 fair market value has fallen and is now \$2 billion. That \$2 billion plus the \$1.4 billion of  
16 Goodwill that has remained on Company A's books (a total of \$3.4 billion) to the \$4.4  
17 billion it had recorded as Company B's value on its books. The difference between the two  
18 is \$1 billion, and Company A must therefore reduce the Goodwill on its books by that  
19 amount to recognize the impairment. The Goodwill entry on its balance sheet goes from  
20 \$1.4 billion to \$400 million, and its total assets fall by \$1 billion correspondingly.  
21 Typically, there would also be a reduction to Company A's common equity balance for the  
22 after-tax impact of recognizing the Goodwill impairment.

23 In summary, Goodwill can represent a large amount of a company's net worth, and  
24 acquisitions can involve the purchase of estimated future earnings streams that are  
25 difficult to estimate accurately in advance and result in purchase premium amounts for  
26 Goodwill that are essentially for an intangible asset. As noted above, Goodwill is an

1 intangible that does not provide service, and which is unlike utility plant which is tangible  
2 and is used in the provision of utility service.

3 When a company records a Goodwill impairment, it is basically telling the market  
4 that the value of the acquired assets has fallen below what the company generally paid for  
5 them.

6  
7 **Q. Can you provide a few illustrative examples of historical Goodwill impairments?**

8 A. Yes. Some of the most famous Goodwill impairments have occurred after large  
9 acquisitions, including Qwest's \$41 billion Goodwill impairment (this followed the  
10 acquisition/merger of Qwest and US West) and AOL-Time Warner's \$54 billion Goodwill  
11 impairment charges in 2002.<sup>21</sup> In conjunction with utility acquisitions, in 2006, Scottish  
12 Power recorded a Goodwill impairment of 922 million British pounds as an exceptional  
13 charge related to goodwill impairment at its then discontinued PacifiCorp operations.<sup>22</sup> In  
14 some of the years following its acquisition of and merger with Commonwealth Edison  
15 Company (ComEd), Exelon Corporation recognized a significant Goodwill impairment  
16 charge of approximately \$776 million in the third quarter of 2006 after issuance of a 2005  
17 ComEd rate case decision by the Illinois Commerce Commission.<sup>23</sup>

18  
19 **Q. Has Fortis explained how it tests for impairment of recorded Goodwill amounts?**

20 A. Yes. The Fortis Inc. 2013 Annual Report at pages 88-89 explains the concept of Goodwill  
21 and how Fortis has applied impairment testing of amounts recorded as Goodwill:

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<sup>21</sup> Illustrative copies of news articles describing these Goodwill impairments are included in Attachment RCS-4.

<sup>22</sup> Id.

<sup>23</sup> A footnote in the Exelon Corporation financial statements has the following description: "2006 Interim Goodwill Impairment Assessment. Due to the significant negative impact of the ICC's July 2006 order in ComEd's 2005 Rate Case to the cash flows and value of ComEd, an interim impairment assessment was completed during the third quarter of 2006. Based on the results of this interim goodwill impairment analysis, which was performed using the same model and assumptions discussed above, Exelon and ComEd recorded a charge of \$776 million associated with the impairment of goodwill during the third quarter of 2006."

1 Goodwill represents the excess, at the dates of acquisition, of the purchase  
2 price over the fair value of the net tangible and identifiable intangible  
3 assets acquired and liabilities assumed relating to business acquisitions.  
4 Goodwill is carried at initial cost less any write-down for impairment.

5 Fortis performs an annual internal quantitative assessment for each  
6 reporting unit and, for those reporting units where: (i) management's  
7 assessment of quantitative and qualitative factors indicates that fair value is  
8 not 50% or more likely to be greater than carrying value; or (ii) where the  
9 excess of estimated fair value over carrying value, as determined by an  
10 independent external consultant as of the date of the immediately preceding  
11 impairment test, was not significant, then fair value of the reporting unit  
12 will be estimated by an independent external consultant in the current year.  
13 Irrespective of the above-noted approach, a reporting unit to which  
14 goodwill has been allocated may have its fair value estimated by an  
15 independent external consultant as at the annual impairment date, as Fortis  
16 will, at a minimum, have fair value for each reporting unit estimated by an  
17 independent external consultant once every three years.

18 Fortis performs the annual impairment test as at October 1. In addition, the  
19 Corporation also performs an impairment test if any event occurs or if  
20 circumstances change that would indicate that the fair value of a reporting  
21 unit is below its carrying value. No such event or change in circumstances  
22 occurred during 2013 or 2012 and no impairment provisions were required  
23 in either year.

24 In calculating goodwill impairment, Fortis determines those reporting units  
25 that will have fair value estimated by an independent external consultant, as  
26 described above, and such estimated fair value is then compared to the  
27 book value of the applicable reporting units. If the fair value of the  
28 reporting unit is less than the book value, then a second measurement step  
29 is performed to determine the amount of the impairment. The amount of the  
30 impairment is determined by deducting the fair value of the reporting unit's  
31 assets and liabilities from the fair value of the reporting unit to determine  
32 the implied fair value of goodwill, and then comparing that amount to the  
33 book value of the reporting unit's goodwill. Any excess of the book value  
34 of the goodwill over the implied fair value is the impairment amount  
35 recognized.

36 The primary method for estimating fair value of the reporting units is the  
37 income approach, whereby net cash flow projections for the reporting units  
38 are discounted using an enterprise value approach. Under the enterprise  
39 value approach, sustainable cash flow is determined on an after-tax basis,  
40 prior to the deduction of interest expense, and is then discounted at the  
41 weighted average cost of capital to yield the value of the enterprise. An  
42 enterprise value approach does not assess the appropriateness of the  
43 reporting unit's existing debt level. The estimated fair value of the  
44 reporting unit is then determined by subtracting the fair value of the

1 reporting unit's interest-bearing debt from the enterprise value of the  
2 reporting unit. A secondary valuation method, the market approach, is also  
3 performed by an independent external consultant as a check on the  
4 conclusions reached under the income approach. The market approach  
5 includes comparing various valuation multiples underlying the discounted  
6 cash flow analysis of the applicable reporting units to trading multiples of  
7 guideline entities and recent transactions involving guideline entities,  
8 recognizing differences in growth expectations, product mix and risks of  
9 those guideline entities with the applicable reporting units.

10  
11 **Q. If a large additional amount of Goodwill is recorded related to Fortis' proposed**  
12 **acquisition of UNS Energy, could that present additional challenges to Fortis to**  
13 **avoid an impairment related write-down?**

14 **A.** Yes. As noted above, post-acquisition impairments of Goodwill at other companies have  
15 occurred. Having large amounts of non-revenue producing assets, such as an intangible  
16 like Goodwill, present risks of prospective impairment write-offs, which, if the occur, will  
17 also tend to reduce the common equity balances that have been recorded on the entity's  
18 books and may therefore hinder future investments.

19  
20 **Q. Do the conditions proposed by Joint Applicants appear to be reasonable for**  
21 **protecting Arizona ratepayers from having to pay for the Goodwill that would be**  
22 **recorded as a result of the proposed transaction?**

23 **A.** Yes. However, as noted above, the mere presence of a very large amount of Goodwill  
24 may create pressures on management to generate other means of improving earnings  
25 and/or achieving a return on and of the recorded Goodwill amounts. Moreover, an  
26 impairment of Goodwill could affect Fortis' balance sheet and financial strength.  
27 Maintaining or improving upon current credit ratings and access to capital is an important  
28 factor to the success of the proposed merger. In addition to the Joint Applicant's  
29 conditions, RUCO recommends that Fortis and UNS Energy report to the Commission

1 within five business days any changes in the credit ratings of Fortis, Inc., UNS Energy,  
2 TEP, UNS Electric or UNS Gas.

3  
4 **Transaction Costs**

5 **Q. Will Fortis incur other transaction costs in addition to the Goodwill discussed above?**

6 A. Yes. Fortis will incur other transaction costs related to its proposed acquisition of UNS  
7 Energy. Fortis' 2013 Annual Report at page 45, for example, states that:

8 Fortis also expects to incur a number of costs associated with completing  
9 the acquisition. The majority of these costs will be non-recurring expenses  
10 and will consist of transaction costs related to the acquisition, including  
11 costs related to financing and obtaining regulatory approval. Additional  
12 unanticipated costs may be incurred in 2014 related to the acquisition.

13  
14 **Q. The Joint Applicants have also proposed a condition to protect Arizona ratepayers  
15 from having to pay for transaction costs. Is that condition sufficient?**

16 A. The Joint Applicants' proposed condition for transaction costs, which provides that such  
17 costs "will be excluded from the rate base, expenses, and capitalization in the  
18 determination of rates and earned returns of the Arizona Utilities and for Arizona state  
19 regulatory accounting and reporting purposes." This condition appears to be adequate,  
20 providing that it is clear that the transaction costs being excluded include costs under the  
21 UNS Energy Change of Control provision and costs for retention payments for UNS  
22 Energy management (sometimes referred to as retention bonuses). The Change in Control  
23 costs and the Retention Bonuses are discussed in additional detail below. Such costs  
24 would not be incurred but for the proposed transaction and should therefore be part of the  
25 excluded transaction costs.

26

27

**Change in Control Costs**

**Q. Please discuss the Change in Control costs that would be incurred as a result of the proposed transaction.**

A. The proposed transaction would constitute a Change of Control and would thus trigger recognition of various costs as described in the confidential response to RUCO Fortis 2.32.

**Q. What amount of Change in Control cost is expected to be incurred?**

A. According to the confidential response to RUCO UNS 1.04, Change in Control costs of [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] are expected to be incurred as a result of the proposed transaction.

**Q. Should the Change in Control costs be considered part of the transaction costs and be excluded from the rate base, expenses, and capitalization in the determination of rates and earned returns of the Arizona Utilities and for Arizona state regulatory accounting and reporting purposes?**

A. Yes.

**Retention Bonuses**

**Q. Please discuss the Retention Bonuses cost that would be incurred as a result of the proposed transaction.**

A. According to the response to RUCO Fortis 2.11 and RUCO UNS 1.04 and 2.02, Retention Bonuses costs [BEGIN CONFIDENTIAL] [REDACTED]  
[REDACTED]  
[REDACTED] [END CONFIDENTIAL]

1     **Q.     Should the Retention Bonuses costs be considered part of the transaction costs and**  
2     **be excluded from the rate base, expenses, and capitalization in the determination of**  
3     **rates and earned returns of the Arizona Utilities and for Arizona state regulatory**  
4     **accounting and reporting purposes?**

5     **A.     Yes.   The Retention Bonus amounts would not be incurred, but for the proposed**  
6     **transaction and should therefore be considered to be part of the transaction costs that are**  
7     **being excluded.**

8  
9     **VIII.   UNS ENERGY SHAREHOLDER LITIGATION COSTS**

10    **Q.     Has the proposed acquisition resulted in certain UNS Energy shareholders filing**  
11    **lawsuits?**

12    **A.     Yes. For example, the Fortis Inc. 2013 Annual Report at page 135 states that:**

13           Following the announcement of the proposed acquisition of UNS Energy  
14           on December 11, 2013, several complaints, which named Fortis and other  
15           defendants, were filed in the Superior Court of Arizona, Pima County, and  
16           the United States District Court of the District of Arizona, challenging the  
17           proposed acquisition. The complaints generally allege that the directors of  
18           UNS Energy breached their fiduciary duties in connection with the  
19           proposed acquisition and that UNS Energy, Fortis, FortisUS Inc. and Color  
20           Acquisition Sub Inc. aided and abetted that breach.

21           The outcome of these lawsuits cannot be predicted with any certainty and,  
22           accordingly, no amount has been accrued in the consolidated financial  
23           statements. An adverse judgment for monetary damages could have a  
24           material adverse effect on the operations of the surviving company after the  
25           completion of the acquisition. A preliminary injunction could delay or  
26           jeopardize the completion of the acquisition and an adverse judgment  
27           granting permanent injunctive relief could indefinitely enjoin completion of  
28           the transaction. Subject to the foregoing, in management's opinion, based  
29           upon currently known facts and circumstances, the outcome of such  
30           lawsuits is not expected to have a material adverse effect on the  
31           consolidated financial condition of Fortis. The defendants intend to  
32           vigorously defend themselves against the lawsuits.

33           The response to RUCO Fortis 2.09 indicates that a number of lawsuits have been  
34           filed by shareholders of UNS Energy concerning the proposed transaction. Additionally,



1 the Joint Applicants' response to UDR 1.33 describes the nature and current status of  
2 litigation concerning the acquisition and states that five putative shareholder class action  
3 lawsuits challenging the merger have been filed, and provides some high level information  
4 about those shareholder lawsuits.

5  
6 **Q. Did you ask the Joint Applicants if litigation costs are being charged to UNS**  
7 **subsidiaries?**

8 A. Yes. Data request RUCO Fortis 2.09 asked about the UNS Energy shareholder litigation  
9 costs. The response to RUCO Fortis 2.09(a) indicates that the costs related to this  
10 shareholder litigation will be an expense on the books of UNS Energy. The response  
11 states further that Fortis anticipates injecting equity to fund acquisition related costs that  
12 are being expensed by UNS Energy.

13  
14 **Q. How are litigation costs charged to UNS subsidiaries?**

15 A. In response to data request RUCO Fortis 2.09(b), Fortis responded:

16 The merger related costs recorded on UNS Energy's books are allocated to  
17 subsidiaries using the allocation method described by UNS Energy in UDR  
18 1.14. All merger related costs are tracked using identifiable accounting  
19 coding to allow them to be removed for rate making purposes from each  
20 subsidiary.

21 The Joint Applicants' response to RUCO Fortis 2.09, however, did not provide the  
22 amounts charged to each utility to date, nor did the response specify the accounts on each  
23 utility subsidiary's books into which these UNS Energy shareholder litigation costs are  
24 being charged.

25  
26 **Q. Does Fortis agree that these shareholder litigation costs should be borne by**  
27 **shareholders and not charged to the ratepayers of any of the Arizona utilities?**

1 A. Yes. The response to RUCO Fortis 2.09(c) states that: "Yes. Fortis agrees that none of the  
2 costs related to the litigation should be borne by the customers of TEP, UNS Electric or  
3 UNS Gas." Moreover, "Fortis has committed that transaction costs will not be recovered  
4 from customers through rates."

5  
6 **Q. Should a condition be placed on the proposed acquisition and merger to require that**  
7 **none of the UNS Energy shareholder litigation costs are charged to the Arizona**  
8 **utilities or their ratepayers?**

9 A. Yes. This could potentially be accomplished by clarifying that the transaction costs that  
10 Fortis has committed will not be borne by the customers of TEP, UNSE or UNSG include  
11 all costs of shareholder litigation related to the proposed transaction.

12  
13 **IX. CONFIRMATION THAT THERE IS NO INTERNAL REVENUE CODE**  
14 **§338(H)(10) ELECTION**

15 **Q. Did you investigate and confirm that there is no Internal Revenue Code §338(h)(10)**  
16 **election being made related to this proposed acquisition?**

17 A. Yes. The response to RUCO UNS 1.02 confirmed that there is no §338(h)(10) election  
18 being made related to the proposed Fortis-UNS acquisition.

19  
20 **Q. Why did you deem it important to confirm that?**

21 A. The application does not contain an election under Internal Revenue Code §338(h)(10),  
22 which would result in treating the stock purchase as an asset purchase for federal income  
23 tax purposes. Such a tax election if made could eliminate the Accumulated Deferred  
24 Income Tax ("ADIT") balance that has been accumulating for years on the books of the  
25 acquired utilities. Because ADIT functions as a substantial rate base deduction, this type  
26 of tax election could present an additional form of ratepayer harm. Where this type of tax

1 election is seen, in order to protect the utility ratepayers from the rate base increase related  
2 to this detrimental aspect caused by the change in ownership, a hold harmless provision  
3 that will protect ratepayers from substantial rate base increases caused by the ownership  
4 change must be incorporated into the conditions for approval. Because the Fortis-UNS  
5 transaction does not incorporate this type of tax election, additional specially tailored  
6 ratepayer protections to help counteract its impact in eliminating utility ADIT do not  
7 appear to be needed.  
8

9 **X. BOND RATINGS / CHANGES TO COST OF DEBT / POST MERGER CAPITAL**  
10 **STRUCTURE**

11 **Q. Please discuss the present bond ratings of Fortis and the UNS Energy utilities.**

12 A. Joint Applicants provided information on the current bond ratings for each of the Arizona  
13 utilities in their responses to UDR 1.08 through UDR 1.10 and for UNS Energy in  
14 response to UDR 1.11.<sup>24</sup> Bond/debt rating information for Fortis Inc. was provided in  
15 response to UDR 1.16.<sup>25</sup>  
16

17 **Q. How do the Joint Applicants anticipate that the cost of debt for TEP, UNS Electric**  
18 **and UNS Gas will be impacted by the proposed transaction?**

19 A. The response to UDR 1.30 describes their expectation that the cost of new long-term debt  
20 could be lower if credit ratings are upgraded:

21 The cost of new long-term debt issued by TEP should be lower as a result  
22 of anticipated upgrades of TEP's credit ratings by S&P and Fitch than the  
23 cost would otherwise be absent the acquisition. The extent of cost savings  
24 to be realized would depend on a variety of factors including (i) the  
25 maturity date of the debt being issued, (ii) the extent of the credit rating  
26 upgrade(s), and (iii) the interest rate spread demanded by the market for  
27 utility bonds at different credit rating levels. Likewise, the cost of short-  
28 term debt under TEP's revolving credit facility would be lower as a result

<sup>24</sup> Copies of these responses are included in Attachment RCS-5.

<sup>25</sup> Id.

1 of a credit rating upgrade. Under TEP's current revolving credit facility the  
2 cost of short-term borrowing would decrease by 12.5 basis points and the  
3 cost of TEP's letters of credit would decrease by 12.5 to 25 basis points if  
4 either S&P or Moody's increased TEP's credit rating by one notch.

5 The debt obligations of UNS Gas and UNS Electric are presently rated only  
6 by Moody's Service. Moody's has remarked that the merger should be  
7 credit neutral to slightly positive for UNS Energy and its subsidiaries. If a  
8 ratings upgrade by Moody's were to occur, the cost of new long-term debt  
9 issued by UNS Gas and UNS Electric should be lower than it would  
10 otherwise be absent the acquisition. With regard to short-term borrowings  
11 under the joint revolving credit facility shared by UNS Gas and UNS  
12 Electric, a one-notch upgrade from Moody's would also result in a 12.5  
13 basis point reduction to the cost of short-term borrowing.

14

15 **Q. Will UNS Energy continue to issue debt in connection with the merger?**

16 A. The response to UDR 1.32 indicates that UNS Energy will issue no debt in connection  
17 with the merger; however, it may borrow on a short-term basis to finance projects, such as  
18 Gila River Unit 3, with the expectation that such short-term debt would be paid off upon  
19 closing the merger with Fortis:

20 UNS Energy will issue no debt in connection with the merger. However, if  
21 the merger is not completed prior to the planned purchase of Gila River  
22 Unit 3 by TEP and UNS Electric in December 2014, UNS Energy will  
23 borrow on a short-term basis and contribute the proceeds to TEP and UNS  
24 Electric to fund a portion of the Gila River purchase price and to TEP for  
25 its purchase of a portion of Springerville Unit 1. It is anticipated that any  
26 such short-term borrowing by UNS Energy would be paid off upon closing  
27 of the merger with Fortis.

28

29 **Q. What capital structure is anticipated for UNS Energy, post-acquisition?**

30 A. The response to UDR 1.31 provides the following information on the pre- and post-  
31 acquisition capital structure for UNS Energy:

**UNS Energy Consolidated Capital Structure**

(S Thousands)	Pre Acquisition Balance as of 9/30/2013	Pro Forma Adjustments For Acquisition Contribution and Generation Purchases	Post Acquisition Pro Forma Balance
Common Equity	\$1,132,286	\$200,000	\$1,332,286
Long-Term Debt	\$1,505,536	\$157,000	\$1,662,536
Short-Term Debt	\$23,000	-	\$23,000
	<u>\$2,660,822</u>	<u>\$357,000</u>	<u>\$3,017,822</u>
% Common Equity	42.6%		44.1%

Note: Pro forma adjustments reflect anticipated financing for the following generation purchases:

\$219,000	Gila River Unit 3 in December 2014 (75% TEP, 25% UNS Electric)
\$65,000	Springerville Unit 1 in Dec. 2014 and Jan. 2015 (TEP)
<u>\$73,000</u>	Springerville coal handling facilities in April 2015 (TEP)
\$357,000	

1  
2 **Q. Are you recommending any conditions with respect to the bond ratings or capital**  
3 **structure?**

4 **A.** Yes. Because changes in bond ratings for the Arizona utilities, UNS Energy and Fortis  
5 Inc. that occur after the transaction is consummated could have a major impact on whether  
6 the cost of debt and access to capital on reasonable terms improves or deteriorates, I  
7 recommend that a condition be added that: Fortis and UNS Energy shall report to the  
8 Commission within five business days any changes in the credit ratings of Fortis, Inc.,  
9 UNS Energy, TEP, UNS Electric or UNS Gas.

10  
11 **XI. PRESERVING TEP SPRINGERVILLE SECTION 45 SYNFUEL BENEFITS FOR**  
12 **ARIZONA RATEPAYERS**

13 **Q.** During the last TEP rate case, did you become aware that TEP has been pursuing an  
14 arrangement with a third party to set up a Section 45 synfuel operation at the  
15 Springerville Plant?

1 A. Yes. TEP was investigating and/or had plans to sell coal for Springerville Units 1 and 2 to  
2 a third party and to buy-back treated coal from the third party for burn at Springerville  
3 Units 1 and 2 so that Internal Revenue Code Section 45 (formerly Section 29) credits can  
4 be generated.

5  
6 **Q. What is the current status of those plans?**

7 A. The response to RUCO UNS 2.07 states that: "TEP is currently in discussions with TCG  
8 Global to refine coal which will qualify for tax credits under IRC Section 45(c)(7) and not  
9 under IRC Section 29. TCG Global is marketing the project to several tax investors and  
10 we plan to proceed as soon as they are successful."

11  
12 **Q. Does TEP anticipate that such arrangements will reduce the cost of coal burned at  
13 Springerville?**

14 A. Yes. TEP's response to RUCO-UNS 2.07(a) states that the contemplated arrangement is  
15 expected to reduce the cost of coal to Springerville between \$1.00/ton and \$2.00/ton in  
16 each of the years in the period 2014-2018. If the project begins refining coal by October  
17 2014 the fuel reduction in 2014 will be approximately \$1.2 Million based on the midpoint  
18 of \$1.50 per ton and 800,000 tons burned in the last quarter of 2014. The anticipated  
19 reduction in years 2015 through 2018 is approximately \$3.6 Million based on a burn of 2.4  
20 Million tons.

21  
22 **Q. Has it been TEP's stated intention to flow the benefits of this arrangement through to  
23 ratepayers through its PPFAC?**

24 A. Yes. That was our understanding from discussions about this during the TEP rate case  
25 investigation. Additionally, the response to RUCO UNS 2.07(c) affirms that: "This  
26 benefit will be passed through to customers as a reduction of PPFAC eligible fuel costs."

1  
2 **Q. How does TEP propose to account for the net benefits of the Section 45**  
3 **arrangement?**

4 A. The response to RUCO UNS 2.07(b) contains the following explanation:

5 As coal is purchased, it is recorded in an inventory account until consumed.  
6 In the transaction described in this request, the coal initially would have  
7 been recorded to inventory at its original cost. When sold to the third-party,  
8 the inventory would be relieved by its original cost, with no gain or loss  
9 resulting from that sale. When it was bought-back at a later date, the new  
10 lower price would be recorded as the new inventory carrying amount.  
11 Accordingly, there are no anticipated costs under the current arrangement,  
12 simply a reduction in FERC 501 fuel expenses.

13  
14 **Q. Has TEP or UNS Energy provided any information to Fortis about entering into an**  
15 **arrangement with a third party to generate Section 45 (formally Section 29) credits**  
16 **for coal treatments at Springerville or any other coal-fired generating plants in**  
17 **which TEP has an ownership or lease interest during the period 2014-2018?**

18 A. This question was posed to TEP in RUCO UNS 2.08, and the response received was:  
19 "No."  
20

21 **Q. Does Fortis have any experience with coal-fired generation?**

22 A. No. According to the response to RUCO Fortis 2.15:

23 Fortis does not have experience with the operation or ownership of coal  
24 fired generation within its existing utility businesses. However, there will  
25 be no changes in the current operation or ownership of the coal fired  
26 generating plants that will continue to be locally operated and managed by  
27 experienced UNS Energy and TEP personnel.

28  
29 **Q. Would it be prudent as a merger condition to formalize TEP's commitment to pass**  
30 **the benefits of the reduced Springerville coal costs resulting from the Section 45**  
31 **synfuel arrangement to ratepayers through TEP's PPFAC?**

1 A. Yes. Given the fact that Fortis has no prior experience with utilities owning and operating  
2 coal-fired generation and the fact that TEP and UNS apparently had not previously  
3 notified Fortis of the Springerville Section 45 arrangement being pursued by TEP, it  
4 would be prudent to formalize TEP's commitment to pass the benefits of the reduced  
5 Springerville coal costs resulting from the arrangement to ratepayers through TEP's  
6 PPFAC. This will help ensure that such benefits flow through to ratepayers as intended by  
7 TEP under the new corporate ownership. A merger condition should therefore reaffirm in  
8 writing TEP's stated commitment to benefits of the reduced Springerville coal costs  
9 resulting from the Section 45 synfuel arrangement to ratepayers through TEP's PPFAC,  
10 and ensure that these benefits are not subsequently diverted to Fortis Inc. shareholders.

11

12 **XII. LUXEMBOURG CONDUIT / INTER-COMPANY DEBT FINANCING / IMPACT**  
13 **ON FORTIS' ANTICIPATED EARNINGS ACCRETION**

14 **Q. Please discuss the use by Fortis of a Luxembourg conduit entity and the related**  
15 **inter-company debt financing.**

16 A. An important component of Fortis' proposed financing involves the use of a Luxembourg  
17 conduit entity and related inter-company debt financing. This arrangement was not  
18 disclosed in the Joint Application or direct testimony. It was uncovered only by reviewing  
19 Fortis' financing details in the "due diligence" documentation.

20

21 **Q. Did you ask Fortis why this key component of its anticipated financing arrangements**  
22 **was not disclosed in the application or in Applicants' direct testimony?**

23 A. Yes. In response to RUCO Fortis 2.02, Fortis provided the following explanation:

24 Fortis provided a high level overview of its plan to finance the acquisition  
25 of UNS Energy in the pre-filed testimony of Barry V. Perry. In the pre-filed  
26 testimony, it was explained that Fortis plans to finance the acquisition by  
27 issuing a combination of common shares, preferred shares and debt  
28 financing. This is still the case. Fortis has already secured a substantial



1 portion of the equity financing by issuing C\$1.8 billion of convertible  
2 debentures which will convert to common equity once all regulatory and  
3 governmental approvals required to finalize the acquisition have been  
4 obtained and all other outstanding conditions under the Merger Agreement  
5 have been fulfilled or waived.

6 The use of an overseas conduit entity was not specifically referred to in the  
7 joint notice or pre-filed testimony as it represents internal funding of  
8 FortisUS by Fortis that was not considered necessary to be included in  
9 order to meet the Commission's filing standard. Overseas conduit entities  
10 are a commonly used mechanism to finance cross-border transactions in  
11 organizations where the parent company resides in Canada and a subsidiary  
12 resides in the United States (or vice versa). The use of an overseas conduit  
13 entity allows Fortis to take advantage of international tax treaties to finance  
14 cross-border subsidiaries. A similar overseas conduit structure was used by  
15 Fortis in funding the FortisUS acquisition of CH Energy Group, Inc. in  
16 2013.

17  
18 **Q. Did Fortis ultimately provide an organizational chart that included disclosure of the**  
19 **Luxembourg conduit entity?**

20 A. Yes. Fortis' response to RUCO Fortis 2.01 included a Fortis corporate organizational  
21 chart similar to that provided in Exhibit 4 to the Joint Notice of Intent to Reorganize,  
22 modified to include the Luxembourg affiliate conduit (i.e., Fortis Energy Corporation,  
23 Newfoundland Energy Holdings Inc., and NewfoundlandEnergy Luxembourg S.à.r.l.).

24  
25 **Q. How much inter-company debt does Fortis anticipate using relating to financing the**  
26 **transaction and which entities does Fortis intend to use for that purpose?**

27 A. As described in the response to RUCO Fortis 2.04, additional intercompany loans from the  
28 Luxembourg conduit to FortisUS of at least US\$500 million would be used as an  
29 intercompany debt arrangement that is part of the plan Fortis intends to employ to  
30 repatriate UNS Energy dividends.

31

1     **Q.**     Does inter-company debt financing of an amount of US\$500 million (or more) seem  
2             like part of the financing arrangement that should have been disclosed up-front in  
3             the Joint Application?

4     A.     Yes, it does. A.A.C. R14-2-803 requires disclosure of the proposed method of financing  
5             the holding company. Referring to Applicant's Post-Merger organizational chart in  
6             Exhibit 2 of the Application there is no disclosure of the Luxembourg conduit entity, and  
7             no discussion in the Application about the inter-company debt arrangement or the fact that  
8             such intercompany debt was anticipated to be used by the FortisUS holding company.

9  
10    **Q.**     Did Fortis provide a public version of its proposed inter-company debt and UNS  
11             Energy dividend repatriation plan in response to RUCO discovery?

12    A.     Yes. Fortis' response to RUCO Fortis 2.04 including Attachment A to that response  
13             provides a public description of that arrangement. The public description includes the  
14             following explanation:

15             RUCO Fortis 2.04 Attachment A.xlsx outlines how the annual dividends of  
16             UNS Energy would be repatriated to Fortis Inc., assuming all the forecast  
17             dividends were repatriated back to Canada. RUCO Fortis 2.04 Attachment  
18             A.xlsx also shows payments by FortisUS of interest on intercompany loans  
19             from its Luxembourg affiliate, NewfoundlandEnergy Luxembourg  
20             S.A.R.L.

21             **Dividends of UNS Energy to FortisUS**

22             FortisUS would hold all of the common equity of UNS Energy. Thus,  
23             FortisUS would receive all of the dividends paid by UNS Energy. As  
24             committed to by Fortis and UNS Energy in the Joint Notice of Intent to  
25             Reorganize, the board of directors of UNS Energy will be responsible for  
26             the establishment of dividend policy and the declaration of dividends to be  
27             paid by UNS Energy.

28             **FortisUS**

29             FortisUS is a Delaware corporation and a direct wholly owned subsidiary  
30             of FortisUS Holdings Nova Scotia Limited which in turn is a direct wholly  
31             owned subsidiary of Fortis Inc.

32             FortisUS is also the parent company of CH Energy Group, Inc. and  
33             FortisUS Energy Corporation and would also receive dividends from these

1 companies. At December 31, 2013, FortisUS had a capital structure  
2 comprised of approximately US\$590 million in common equity and  
3 US\$450 million in interest bearing long-term debt from  
4 NewfoundlandEnergy Luxembourg S.A.R.L.

5 The pro-forma capital structure of FortisUS, assuming an acquisition price  
6 for UNS Energy equity of US\$2.5 billion and a post-closing common  
7 equity injection of US\$200 million, would increase by US\$2.7 billion. The  
8 new capital of FortisUS would be comprised of additional common equity  
9 of US\$2.2 billion from FortisUS Holding Nova Scotia Limited and  
10 additional intercompany loans from NewfoundlandEnergy Luxembourg  
11 S.A.R.L. of US\$500 million.

12 **Payment of UNS Energy Dividends**

13 Assuming an annual dividend of US\$80 million from UNS Energy to  
14 FortisUS, Fortis anticipates that FortisUS would pay interest of US\$25  
15 million on its intercompany loans from NewfoundlandEnergy Luxembourg  
16 S.A.R.L. (US\$500 million in loans at an interest rate of 5%). The  
17 remaining US\$55 million, if repatriated to Canada, would be paid as a  
18 dividend from FortisUS to FortisUS Holdings Nova Scotia Limited. The  
19 dividend from FortisUS to its Canadian parent would be subject to a 5%  
20 withholding tax in accordance with IRS rules.

21 FortisUS Holdings Nova Scotia Limited would pay the dividend received  
22 from FortisUS, net of the 5% withholding tax, (i.e., US\$52.25 million) as a  
23 dividend to Fortis Inc.

24 **Payment of Interest to Luxembourg Affiliate**

25 The interest payment of US\$25 million by FortisUS to  
26 NewfoundlandEnergy Luxembourg S.A.R.L. would be assessed income tax  
27 in Luxembourg of approximately US\$150,000. NewfoundlandEnergy  
28 Luxembourg S.A.R.L. would therefore pay a dividend, net of Luxembourg  
29 income tax and administrative expenses totaling approximately  
30 US\$200,000, (i.e., US\$24.8 million) to its Canadian parent, Newfoundland  
31 Energy Holdings Inc. Newfoundland Energy Holdings Inc. would then pay  
32 this US\$24.8 million as a dividend to its parent, Fortis Energy Corporation.  
33 Fortis Energy Corporation would, in turn, pay US\$24.8 million as a  
34 dividend to its parent, Fortis Inc.

35  
36 **Q.** Is there also a CONFIDENTIAL AND COMPETITIVELY SENSITIVE document  
37 showing and describing the Fortis inter-company debt and UNS Energy dividend  
38 repatriation -plan that Fortis has proposed to utilize?

1 A. Yes. Attachment RCS-6 includes 2 pages of copies obtained from the UNS Energy "due  
2 diligence" review containing [BEGIN CONFIDENTIAL AND COMPETITIVELY  
3 SENSITIVE] [REDACTED]  
4 [REDACTED] [END CONFIDENTIAL AND  
5 COMPETITIVELY SENSITIVE] Because such material from the UNS Energy "due  
6 diligence" documentation is considered CONFIDENTIAL AND COMPETITIVELY  
7 SENSITIVE, so I will not include any further discussion of such contents in my  
8 testimony.

9  
10 Q. Is Fortis expecting that its acquisition of UNS Energy will be accretive to the  
11 earnings of Fortis Inc.?

12 A. Yes. Excluding the impact of transaction costs, Fortis had announced that it expects its  
13 acquisition of UNS Energy will be accretive to the earnings of Fortis Inc.

14  
15 Q. Have you reviewed Fortis' estimates of the Fortis Inc. earnings accretion?

16 A. Yes, to the extent that Fortis' estimates of the Fortis Inc. earnings accretion expected to  
17 result from its acquisition of UNS Energy were disclosed in responses to discovery or  
18 Fortis news announcements or in the Fortis "due diligence" documentation.

19  
20 Q. Approximately how much of the Fortis Inc. estimated earnings accretion in the first  
21 four years of ownership is produced by the inter-company debt and Luxembourg  
22 conduit arrangement?

23 A. [BEGIN CONFIDENTIAL AND COMPETITIVELY SENSITIVE] [REDACTED]  
24 [REDACTED]  
25 [REDACTED]

26 [END

CONFIDENTIAL AND COMPETITIVELY SENSITIVE]

**Q. Is having the acquisition being accretive to the earnings of Fortis Inc. important to Fortis?**

**A. Yes. Data request RUCO Fortis 2.16 asked:**

Is being accretive to Fortis' earnings in the first year (2015) or in other years in the 2015-2018 time period considered to be a critical element to Fortis in pursuing the proposed acquisition of UNS Energy?

a. Explain fully how important being "accretive to earnings" is to Fortis for this proposed transaction.

Fortis' response states:

Growth in earnings is as important to Fortis as it is to any successful corporation. Earnings growth supports common share dividend growth and adds shareholder value. This ultimately supports the market price of Fortis common shares and enhances Fortis' access to equity capital. In addition, Fortis funds the growth in its existing regulated operations by retaining a significant portion of earnings at the utility level, supplemented by the provision of common equity injections as required.

To finance the acquisition of UNS Energy, Fortis has issued C\$1.8 billion of securities that are convertible to new equity. The Fortis common share price at which this equity was issued is based on shareholders' expectations that the UNS Energy acquisition will be accretive to earnings.

**Q. Does the revealing of the inter-company debt and Luxembourg conduit arrangement that Fortis would employ as part of its financing plan and use for the repatriation of UNS Energy dividends also suggest that access to affiliate books and records may become important?**

26 [BEGIN CONFIDENTIAL AND COMPETITIVELY SENSITIVE]

[END CONFIDENTIAL AND COMPETITIVELY SENSITIVE]

1 A. Yes. The condition proposed by the Joint Applicants regarding access to affiliate books  
2 and records should be strengthened to clearly provide for access to the books and records  
3 of all affiliates that are part of the financing arrangement. This would include the  
4 FortisUS holding company and the Luxembourg conduit entity, as well as any Fortis  
5 entities that would charge or allocate corporate costs to any of the Arizona Utilities.  
6

7 **XIII. ARIZONA RATEPAYER BENEFITS**

8 **Q. Were specific tangible ratepayer benefits provided for in the conditions imposed**  
9 **upon Fortis' acquisition in 2013 of Central Hudson?**

10 A. Yes. As previously noted, the NYPSC approval of Fortis' acquisition of CH Energy, the  
11 parent of the Central Hudson utilities, included tangible quantified economic benefits to  
12 ratepayers including \$9.25 (\$1.85 million for 5 years) of cost savings/guaranteed future  
13 rate mitigation, and \$35 million provided to Central Hudson by Fortis to be recorded as a  
14 regulatory liability to be applied to write off regulatory assets on the books of Central  
15 Hudson for storm restoration and to provide balance sheet offsets and rate mitigation in  
16 Central Hudson's next rate filing. Additionally, the Central Hudson conditions included  
17 an additional \$5 million provided by Fortis for a Community Benefit Fund to be utilized  
18 for low income and economic development purposes. These Fortis-provided benefits for  
19 Central Hudson ratepayers in conjunction with that acquisition/merger transaction total to  
20 \$49.25 million.  
21

22 **Q. Is it important to provide ratepayers in this case as a condition of approval with a**  
23 **specific tangible benefit similar to the one provided by Fortis in the Central Hudson**  
24 **case?**

25 A. Yes. Providing Arizona ratepayer benefits of at least \$59 million by establishing a  
26 regulatory liability account for use in mitigating future utility rate increases, as described

1 above is one way to provide for a specific tangible ratepayer benefit resulting from the  
2 proposed transaction, and will help mitigate risks that the transaction poses for Arizona  
3 ratepayers of the three utilities. As described above, one potential source for such Arizona  
4 ratepayer benefits is sharing a portion of the estimated Fortis, Inc. earnings accretion  
5 related to the inter-company debt/Luxembourg conduit arrangement  
6

7 **Q. How did you arrive at this amount?**

8 A. The amount for Arizona utility ratepayer benefits that RUCO recommends is roughly  
9 comparable to the benefits received by the Central Hudson ratepayers from Fortis in the  
10 New York merger. In that acquisition, Fortis agreed to \$9.25 million in cost  
11 savings/guaranteed future rate mitigation, \$5 million for a Community Benefit Fund and  
12 \$35 million to be recorded as a regulatory liability to be applied to write off regulatory  
13 assets on the books of Central Hudson for storm restoration and to provide balance sheet  
14 offsets and rate mitigation in Central Hudson's next rate filing. In total, the Central  
15 Hudson acquisition included \$49.25 million in ratepayer benefits from Fortis. In the  
16 present case, which is a notably bigger acquisition by Fortis than Central Hudson, RUCO  
17 is recommending \$59 million in ratepayer benefits. Information on Central Hudson's size  
18 has been provided in the response to RUCO Fortis 1.05 and indicates, for example, that  
19 the \$9.25 million amount of guaranteed future rate mitigation represents 1.38 percent of  
20 Central Hudson's 2013 regulated revenue of \$668.4 million. In comparison, \$9.25 million  
21 would be only 0.62 percent of UNS Energy's 2013 operating revenue from the three  
22 Arizona utilities (TEP, UNS Electric, and UNS Gas), which was \$1.485 billion.<sup>27</sup> In terms  
23 of utility revenue, UNS Energy is more than twice as big as Central Hudson. An  
24 argument could be made that the percentage of the benefits should be at the very least the  
25 same or similar for Arizona as it was in New York or that the total benefits for Arizona

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<sup>27</sup> See, e.g., UNS Energy SEC Form 10-K for the fiscal year ended December 31, 2013, page K-101, a copy of which is included in Attachment RCS-5.

1 ratepayers should be proportional to the Central Hudson ratepayer benefits, recognizing  
2 that the three Arizona utilities being acquired here are significantly larger than Central  
3 Hudson. However, all RUCO is recommending is the same ratepayer benefits for UNS  
4 Energy with only the cost savings/guaranteed future rate mitigation costs being doubled.  
5 RUCO's recommendation is balanced and reasonable.  
6

7 **XIV. FORTIS CORPORATE COST INCREASES RESULTING FROM THE MERGER**

8 **Q. How does Fortis anticipate that its corporate costs will be impacted by the proposed**  
9 **merger?**

10 A. As stated in the response to RUCO Fortis 2.29, Fortis estimates that the merger will  
11 increase Fortis' annual corporate general and administrative costs by approximately  
12 C\$700,000.  
13

14 **Q. How does Fortis intend to account for those increased corporate costs?**

15 A. Fortis' response to RUCO Fortis 2.29(a) provided illustrative accounting entries.<sup>28</sup>  
16

17 **Q. Would Fortis' increased corporate costs be charged or allocated to the Arizona**  
18 **Utilities?**

19 A. It appears they would. Fortis' response to RUCO Fortis 2.29(b) provided the following  
20 explanation:

21 Fortis Inc. utilizes a cost allocation method to calculate management fees  
22 charged to its subsidiaries. The allocation to subsidiaries is calculated as a  
23 proportion of Fortis Inc.'s corporate expenses, as per below, excluding: (i)  
24 finance charges associated with credit facilities and long-term debt; (ii)  
25 50% of salary and salary-related expenses of Fortis Inc.'s CEO, CFO and  
26 Treasurer; and (iii) 100% of business development costs. The allocable  
27 costs are charged to the operating subsidiaries based on the percentage of  
28 their assets to the total consolidated assets of Fortis Inc.

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<sup>28</sup> A copy of this response is included in Attachment RCS-5.



1 Fortis Inc.'s costs (i.e., corporate expenses) typically relate to public capital  
2 market access related to investment in operating subsidiaries. Such costs  
3 include governance costs, capital market fees, public reporting  
4 requirements, trustee fees, common share plans and other related fees.  
5 These costs are allocated between regulated and non-regulated operations  
6 by each operating subsidiary as required under appropriate local regulatory  
7 guidelines governing that operating subsidiary. Generally, capital market  
8 costs related to equity are regarded as costs which are appropriately  
9 allocated to regulated operations (because the costs benefit the regulated  
10 subsidiary and are not duplicative), whereas costs such as those related to  
11 governance may not be allocated to regulated operations (because the  
12 regulated subsidiary has its own independent board of directors and  
13 additional governance costs tend to be duplicative).

14 For additional information on Fortis' cost allocation methodology, please  
15 refer to RUCO Fortis 2.29 Attachment 2.pdf, Bates Nos. 002180-002209,  
16 which contains a June 22, 2009 report from KPMG pertaining to a review  
17 of the cost allocation methodology utilized by Fortis Inc. This report  
18 reviewed the cost allocation policy of Fortis Inc. as well as FortisBC  
19 Holdings Inc. (formerly known as Terasen Gas Inc.). Fortis Inc. would  
20 allocate applicable costs to its subsidiaries, including UNS Energy  
21 Corporation, in accordance with the indicated methodology. The  
22 methodology used by UNS Energy to allocate costs to its subsidiaries is  
23 described in UDR 1.14.

24  
25 **Q. Will access to Fortis Inc.'s books and records relating to Fortis' corporate costs that**  
26 **are being charged or allocated to the Arizona Utilities be important?**

27 **A.** Yes. The merger conditions should make clear that access to books and records will be  
28 provided for any entities that are charging or allocating cost to any of the Arizona  
29 Utilities. This would presumably include any accounting records and documentation  
30 related to Fortis Inc. corporate costs.

31  
32 **Q. Does this conclude your testimony?**

33 **A.** Yes, it does.

**Attachment RCS-1**  
**QUALIFICATIONS OF RALPH C. SMITH**

**Accomplishments**

Mr. Smith's professional credentials include being a Certified Financial Planner™ professional, a Certified Rate of Return Analyst, a licensed Certified Public Accountant and attorney. He functions as project manager on consulting projects involving utility regulation, regulatory policy and ratemaking and utility management. His involvement in public utility regulation has included project management and in-depth analyses of numerous issues involving telephone, electric, gas, and water and sewer utilities.

Mr. Smith has performed work in the field of utility regulation on behalf of industry, public service commission staffs, state attorney generals, municipalities, and consumer groups concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, New York, Nevada, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, Washington DC, West Virginia, Canada, Federal Energy Regulatory Commission and various state and federal courts of law. He has presented expert testimony in regulatory hearings on behalf of utility commission staffs and intervenors on several occasions.

Project manager in Larkin & Associates' review, on behalf of the Georgia Commission Staff, of the budget and planning activities of Georgia Power Company; supervised 13 professionals; coordinated over 200 interviews with Company budget center managers and executives; organized and edited voluminous audit report; presented testimony before the Commission. Functional areas covered included fossil plant O&M, headquarters and district operations, internal audit, legal, affiliated transactions, and responsibility reporting. All of our findings and recommendations were accepted by the Commission.

Key team member in the firm's management audit of the Anchorage Water and Wastewater Utility on behalf of the Alaska Commission Staff, which assessed the effectiveness of the Utility's operations in several areas; responsible for in-depth investigation and report writing in areas involving information systems, finance and accounting, affiliated relationships and transactions, and use of outside contractors. Testified before the Alaska Commission concerning certain areas of the audit report. AWWU concurred with each of Mr. Smith's 40 plus recommendations for improvement.

Co-consultant in the analysis of the issues surrounding gas transportation performed for the law firm of Cravath, Swaine & Moore in conjunction with the case of Reynolds Metals Co. vs. the Columbia Gas System, Inc.; drafted in-depth report concerning the regulatory treatment at both state and federal levels of issues such as flexible pricing and mandatory gas transportation.

Lead consultant and expert witness in the analysis of the rate increase request of the City of Austin - Electric Utility on behalf of the residential consumers. Among the numerous ratemaking issues addressed were the economies of the Utility's employment of outside services; provided both written and oral testimony outlining recommendations and their bases. Most of Mr. Smith's recommendations were adopted by the City Council and Utility in a settlement.

Key team member performing an analysis of the rate stabilization plan submitted by the Southern Bell Telephone & Telegraph Company to the Florida PSC; performed comprehensive analysis of the Company's projections and budgets which were used as the basis for establishing rates.

Lead consultant in analyzing Southwestern Bell Telephone separations in Missouri; sponsored the complex technical analysis and calculations upon which the firm's testimony in that case was based. He has also assisted in analyzing changes in depreciation methodology for setting telephone rates.

Lead consultant in the review of gas cost recovery reconciliation applications of Michigan Gas Utilities Company, Michigan Consolidated Gas Company, and Consumers Power Company. Drafted recommendations regarding the appropriate rate of interest to be applied to any over or under collections and the proper procedures and allocation methodology to be used to distribute any refunds to customer classes.

Lead consultant in the review of Consumers Power Company's gas cost recovery refund plan. Addressed appropriate interest rate and compounding procedures and proper allocation methodology.

Project manager in the review of the request by Central Maine Power Company for an increase in rates. The major area addressed was the propriety of the Company's ratemaking attrition adjustment in relation to its corporate budgets and projections.

Project manager in an engagement designed to address the impacts of the Tax Reform Act of 1986 on gas distribution utility operations of the Northern States Power Company. Analyzed the reduction in the corporate tax rate, uncollectibles reserve, ACRS, unbilled revenues, customer advances, CIAC, and timing of TRA-related impacts associated with the Company's tax liability.

Project manager and expert witness in the determination of the impacts of the Tax Reform Act of 1986 on the operations of Connecticut Natural Gas Company on behalf of the Connecticut Department of Public Utility Control - Prosecutorial Division, Connecticut Attorney General, and Connecticut Department of Consumer Counsel.

Lead Consultant for The Minnesota Department of Public Service ("DPS") to review the Minnesota Incentive Plan ("Incentive Plan") proposal presented by Northwestern Bell Telephone Company ("NWB") doing business as U S West Communications ("USWC"). Objective was to express an opinion as to whether current rates addressed by the plan were appropriate from a Minnesota intrastate revenue requirements and accounting perspective, and to assist in developing recommended modifications to NWB's proposed Plan.

Performed a variety of analytical and review tasks related to our work effort on this project. Obtained and reviewed data and performed other procedures as necessary (1) to obtain an understanding of the Company's Incentive Plan filing package as it relates to rate base, operating income, revenue requirements, and plan operation, and (2) to formulate an opinion concerning the reasonableness of current rates and of amounts included within the Company's Incentive Plan filing. These procedures included requesting and reviewing extensive discovery, visiting the Company's offices to review data, issuing follow-up information requests in many instances, telephone and on-site discussions with Company representatives, and frequent discussions with counsel and DPS Staff assigned to the project.

Lead Consultant in the regulatory analysis of Jersey Central Power & Light Company for the Department of the Public Advocate, Division of Rate Counsel. Tasks performed included on-site review and audit of Company, identification and analysis of specific issues, preparation of data requests, testimony, and cross examination questions. Testified in Hearings.

Assisted the NARUC Committee on Management Analysis with drafting the Consultant Standards for Management Audits.

Presented training seminars covering public utility accounting, tax reform, ratemaking, affiliated transaction auditing, rate case management, and regulatory policy in Maine, Georgia, Kentucky, and Pennsylvania. Seminars were presented to commission staffs and consumer interest groups.

### Previous Positions

With Larkin, Chapski and Co., the predecessor firm to Larkin & Associates, was involved primarily in utility regulatory consulting, and also in tax planning and tax research for businesses and individuals, tax return preparation and review, and independent audit, review and preparation of financial statements.

Installed computerized accounting system for a realty management firm.

### Education

Bachelor of Science in Administration in Accounting, with distinction, University of Michigan, Dearborn, 1979.

Master of Science in Taxation, Walsh College, Michigan, 1981. Master's thesis dealt with investment tax credit and property tax on various assets.

Juris Doctor, cum laude, Wayne State University Law School, Detroit, Michigan, 1986. Recipient of American Jurisprudence Award for academic excellence.

Continuing education required to maintain CPA license and CFP® certificate.

Passed all parts of CPA examination in first sitting, 1979. Received CPA certificate in 1981 and Certified Financial Planning certificate in 1983. Admitted to Michigan and Federal bars in 1986.

Michigan Bar Association.

American Bar Association, sections on public utility law and taxation.

Partial list of utility cases participated in:

79-228-EL-FAC	Cincinnati Gas & Electric Company (Ohio PUC)
79-231-EL-FAC	Cleveland Electric Illuminating Company (Ohio PUC)
79-535-EL-AIR	East Ohio Gas Company (Ohio PUC)
80-235-EL-FAC	Ohio Edison Company (Ohio PUC)
80-240-EL-FAC	Cleveland Electric Illuminating Company (Ohio PUC)
U-1933*	Tucson Electric Power Company (Arizona Corp. Commission)
U-6794	Michigan Consolidated Gas Co. --16 Refunds (Michigan PSC)
81-0035TP	Southern Bell Telephone Company (Florida PSC)
81-0095TP	General Telephone Company of Florida (Florida PSC)
81-308-EL-EFC	Dayton Power & Light Co.- Fuel Adjustment Clause (Ohio PUC)
810136-EU	Gulf Power Company (Florida PSC)
GR-81-342	Northern States Power Co. -- E-002/Minnesota (Minnesota PUC)
Tr-81-208	Southwestern Bell Telephone Company (Missouri PSC))
U-6949	Detroit Edison Company (Michigan PSC)
8400	East Kentucky Power Cooperative, Inc. (Kentucky PSC)
18328	Alabama Gas Corporation (Alabama PSC)
18416	Alabama Power Company (Alabama PSC)
820100-EU	Florida Power Corporation (Florida PSC)
8624	Kentucky Utilities (Kentucky PSC)
8648	East Kentucky Power Cooperative, Inc. (Kentucky PSC)
U-7236	Detroit Edison - Burlington Northern Refund (Michigan PSC)
U6633-R	Detroit Edison - MRCS Program (Michigan PSC)
U-6797-R	Consumers Power Company -MRCS Program (Michigan PSC)
U-5510-R	Consumers Power Company - Energy conservation Finance Program (Michigan PSC)
82-240E	South Carolina Electric & Gas Company (South Carolina PSC)
7350	Generic Working Capital Hearing (Michigan PSC)
RH-1-83	Westcoast Transmission Co., (National Energy Board of Canada)
820294-TP	Southern Bell Telephone & Telegraph Co. (Florida PSC)
82-165-EL-EFC (Subfile A)	Toledo Edison Company(Ohio PUC)
82-168-EL-EFC	Cleveland Electric Illuminating Company (Ohio PUC)
830012-EU	Tampa Electric Company (Florida PSC)
U-7065	The Detroit Edison Company - Fermi II (Michigan PSC)
8738	Columbia Gas of Kentucky, Inc. (Kentucky PSC)
ER-83-206	Arkansas Power & Light Company (Missouri PSC)
U-4758	The Detroit Edison Company -- Refunds (Michigan PSC)
8836	Kentucky American Water Company (Kentucky PSC)
8839	Western Kentucky Gas Company (Kentucky PSC)
83-07-15	Connecticut Light & Power Co. (Connecticut DPU)
81-0485-WS	Palm Coast Utility Corporation (Florida PSC)
U-7650	Consumers Power Co. (Michigan PSC)
83-662	Continental Telephone Company of California, (Nevada PSC)
U-6488-R	Detroit Edison Co., FAC & PIPAC Reconciliation (Michigan PSC)
U-15684	Louisiana Power & Light Company (Louisiana PSC)
7395 & U-7397	Campaign Ballot Proposals (Michigan PSC)
820013-WS	Seacoast Utilities (Florida PSC)
U-7660	Detroit Edison Company (Michigan PSC)
83-1039	CP National Corporation (Nevada PSC)
U-7802	Michigan Gas Utilities Company (Michigan PSC)
83-1226	Sierra Pacific Power Company (Nevada PSC)
830465-EI	Florida Power & Light Company (Florida PSC)
U-7777	Michigan Consolidated Gas Company (Michigan PSC)
U-7779	Consumers Power Company (Michigan PSC)

U-7480-R	Michigan Consolidated Gas Company (Michigan PSC)
U-7488-R	Consumers Power Company – Gas (Michigan PSC)
U-7484-R	Michigan Gas Utilities Company (Michigan PSC)
U-7550-R	Detroit Edison Company (Michigan PSC)
U-7477-R**	Indiana & Michigan Electric Company (Michigan PSC)
18978	Continental Telephone Co. of the South Alabama (Alabama PSC)
R-842583	Duquesne Light Company (Pennsylvania PUC)
R-842740	Pennsylvania Power Company (Pennsylvania PUC)
850050-EI	Tampa Electric Company (Florida PSC)
16091	Louisiana Power & Light Company (Louisiana PSC)
19297	Continental Telephone Co. of the South Alabama (Alabama PSC)
76-18788AA	
&76-18793AA	Detroit Edison - Refund - Appeal of U-4807 (Ingham County, Michigan Circuit Court)
85-53476AA	
& 85-534785AA	Detroit Edison Refund - Appeal of U-4758 (Ingham County, Michigan Circuit Court)
U-8091/U-8239	Consumers Power Company - Gas Refunds (Michigan PSC)
TR-85-179**	United Telephone Company of Missouri (Missouri PSC)
85-212	Central Maine Power Company (Maine PSC)
ER-85646001	
& ER-85647001	New England Power Company (FERC)
850782-EI &	
850783-EI	Florida Power & Light Company (Florida PSC)
R-860378	Duquesne Light Company (Pennsylvania PUC)
R-850267	Pennsylvania Power Company (Pennsylvania PUC)
851007-WU	
& 840419-SU	Florida Cities Water Company (Florida PSC)
G-002/GR-86-160	Northern States Power Company (Minnesota PSC)
7195 (Interim)	Gulf States Utilities Company (Texas PUC)
87-01-03	Connecticut Natural Gas Company (Connecticut PUC))
87-01-02	Southern New England Telephone Company (Connecticut Department of Public Utility Control)
3673-	Georgia Power Company (Georgia PSC)
29484	Long Island Lighting Co. (New York Dept. of Public Service)
U-8924	Consumers Power Company – Gas (Michigan PSC)
Docket No. 1	Austin Electric Utility (City of Austin, Texas)
Docket E-2, Sub 527	Carolina Power & Light Company (North Carolina PUC)
870853	Pennsylvania Gas and Water Company (Pennsylvania PUC)
880069**	Southern Bell Telephone Company (Florida PSC)
U-1954-88-102	Citizens Utilities Rural Company, Inc. & Citizens Utilities Company, Kingman Telephone Division (Arizona CC)
T E-1032-88-102	Illinois Bell Telephone Company (Illinois CC)
89-0033	Puget Sound Power & Light Company (Washington UTC))
U-89-2688-T	Philadelphia Electric Company (Pennsylvania PUC)
R-891364	Potomac Electric Power Company (District of Columbia PSC)
F.C. 889	Niagara Mohawk Power Corporation, et al Plaintiffs, v. Gulf+Western, Inc. et al, defendants (Supreme Court County of Onondaga, State of New York)
Case No. 88/546*	
87-11628*	Duquesne Light Company, et al, plaintiffs, against Gulf+Western, Inc. et al, defendants (Court of the Common Pleas of Allegheny County, Pennsylvania Civil Division)
890319-EI	Florida Power & Light Company (Florida PSC)
891345-EI	Gulf Power Company (Florida PSC)
ER 8811 0912J	Jersey Central Power & Light Company (BPU)
6531	Hawaiian Electric Company (Hawaii PUCs)

R0901595	Equitable Gas Company (Pennsylvania Consumer Counsel)
90-10	Artesian Water Company (Delaware PSC)
89-12-05	Southern New England Telephone Company (Connecticut PUC)
900329-WS	Southern States Utilities, Inc. (Florida PSC)
90-12-018	Southern California Edison Company (California PUC)
90-E-1185	Long Island Lighting Company (New York DPS)
R-911966	Pennsylvania Gas & Water Company (Pennsylvania PUC)
I.90-07-037, Phase II	(Investigation of OPEBs) Department of the Navy and all Other Federal Executive Agencies (California PUC)
U-1551-90-322	Southwest Gas Corporation (Arizona CC)
U-1656-91-134	Sun City Water Company (Arizona RUCO)
U-2013-91-133	Havasui Water Company (Arizona RUCO)
91-174***	Central Maine Power Company (Department of the Navy and all Other Federal Executive Agencies)
U-1551-89-102	Southwest Gas Corporation - Rebuttal and PGA Audit (Arizona Corporation Commission)
& U-1551-89-103	Hawaiian Electric Company (Hawaii PUC)
Docket No. 6998	Intrastate Access Charge Methodology, Pool and Rates
TC-91-040A and	Local Exchange Carriers Association and South Dakota
TC-91-040B	Independent Telephone Coalition
9911030-WS &	General Development Utilities - Port Malabar and
911-67-WS	West Coast Divisions (Florida PSC)
922180	The Peoples Natural Gas Company (Pennsylvania PUC)
7233 and 7243	Hawaiian Nonpension Postretirement Benefits (Hawaiian PUC)
R-00922314	
& M-920313C006	Metropolitan Edison Company (Pennsylvania PUC)
R00922428	Pennsylvania American Water Company (Pennsylvania PUC)
E-1032-92-083 &	
U-1656-92-183	Citizens Utilities Company, Agua Fria Water Division (Arizona Corporation Commission)
92-09-19	Southern New England Telephone Company (Connecticut PUC)
E-1032-92-073	Citizens Utilities Company (Electric Division), (Arizona CC)
UE-92-1262	Puget Sound Power and Light Company (Washington UTC))
92-345	Central Maine Power Company (Maine PUC)
R-932667	Pennsylvania Gas & Water Company (Pennsylvania PUC)
U-93-60**	Matanuska Telephone Association, Inc. (Alaska PUC)
U-93-50**	Anchorage Telephone Utility (Alaska PUC)
U-93-64	PTI Communications (Alaska PUC)
7700	Hawaiian Electric Company, Inc. (Hawaii PUC)
E-1032-93-111 &	Citizens Utilities Company - Gas Division
U-1032-93-193	(Arizona Corporation Commission)
R-00932670	Pennsylvania American Water Company (Pennsylvania PUC)
U-1514-93-169/	Sale of Assets CC&N from Contel of the West, Inc. to
E-1032-93-169	Citizens Utilities Company (Arizona Corporation Commission)
7766	Hawaiian Electric Company, Inc. (Hawaii PUC)
93-2006- GA-AIR*	The East Ohio Gas Company (Ohio PUC)
94-E-0334	Consolidated Edison Company (New York DPS)
94-0270	Inter-State Water Company (Illinois Commerce Commission)
94-0097	Citizens Utilities Company, Kauai Electric Division (Hawaii PUC)
PU-314-94-688	Application for Transfer of Local Exchanges (North Dakota PSC)
94-12-005-Phase I	Pacific Gas & Electric Company (California PUC)
R-953297	UGI Utilities, Inc. - Gas Division (Pennsylvania PUC)
95-03-01	Southern New England Telephone Company (Connecticut PUC)
95-0342	Consumer Illinois Water, Kankakee Water District (Illinois CC)
94-996-EL-AIR	Ohio Power Company (Ohio PUC)
95-1000-E	South Carolina Electric & Gas Company (South Carolina PSC)

Non-Docketed	Citizens Utility Company - Arizona Telephone Operations
Staff Investigation	(Arizona Corporation Commission)
E-1032-95-473	Citizens Utility Co. - Northern Arizona Gas Division (Arizona CC)
E-1032-95-433	Citizens Utility Co. - Arizona Electric Division (Arizona CC)
	Collaborative Ratemaking Process Columbia Gas of Pennsylvania
	(Pennsylvania PUC)
GR-96-285	Missouri Gas Energy (Missouri PSC)
94-10-45	Southern New England Telephone Company (Connecticut PUC)
A.96-08-001 et al.	California Utilities' Applications to Identify Sunk Costs of Non-
	Nuclear Generation Assets, & Transition Costs for Electric Utility
	Restructuring, & Consolidated Proceedings (California PUC)
96-324	Bell Atlantic - Delaware, Inc. (Delaware PSC)
96-08-070, et al.	Pacific Gas & Electric Co., Southern California Edison Co. and
	San Diego Gas & Electric Company (California PUC)
97-05-12	Connecticut Light & Power (Connecticut PUC)
R-00973953	Application of PECO Energy Company for Approval of its
	Restructuring Plan Under Section 2806 of the Public Utility Code
	(Pennsylvania PUC)
97-65	Application of Delmarva Power & Light Co. for Application of a
	Cost Accounting Manual and a Code of Conduct (Delaware PSC)
16705	Entergy Gulf States, Inc. (Cities Steering Committee)
E-1072-97-067	Southwestern Telephone Co. (Arizona Corporation Commission)
Non-Docketed	Delaware - Estimate Impact of Universal Services Issues
Staff Investigation	(Delaware PSC)
PU-314-97-12	US West Communications, Inc. Cost Studies (North Dakota PSC)
97-0351	Consumer Illinois Water Company (Illinois CC)
97-8001	Investigation of Issues to be Considered as a Result of Restructuring of Electric
	Industry (Nevada PSC)
U-0000-94-165	Generic Docket to Consider Competition in the Provision
	of Retail Electric Service (Arizona Corporation Commission)
98-05-006-Phase I	San Diego Gas & Electric Co., Section 386 costs (California PUC)
9355-U	Georgia Power Company Rate Case (Georgia PUC)
97-12-020 - Phase I	Pacific Gas & Electric Company (California PUC)
U-98-56, U-98-60,	Investigation of 1998 Intrastate Access charge filings
U-98-65, U-98-67	(Alaska PUC)
(U-99-66, U-99-65,	Investigation of 1999 Intrastate Access Charge filing
U-99-56, U-99-52)	(Alaska PUC)
Phase II of	
97-SCCC-149-GIT	Southwestern Bell Telephone Company Cost Studies (Kansas CC)
PU-314-97-465	US West Universal Service Cost Model (North Dakota PSC)
Non-docketed	Bell Atlantic - Delaware, Inc., Review of New Telecomm.
Assistance	and Tariff Filings (Delaware PSC)
Contract Dispute	City of Zeeland, MI - Water Contract with the City of Holland, MI
	(Before an arbitration panel)
Non-docketed Project	City of Danville, IL - Valuation of Water System (Danville, IL)
Non-docketed Project	Village of University Park, IL - Valuation of Water and
	Sewer System (Village of University Park, Illinois)



E-1032-95-417	Citizens Utility Co., Maricopa Water/Wastewater Companies et al. (Arizona Corporation Commission)
T-1051B-99-0497	Proposed Merger of the Parent Corporation of Qwest Communications Corporation, LCI International Telecom Corp., and US West Communications, Inc. (Arizona CC)
T-01051B-99-0105	US West Communications, Inc. Rate Case (Arizona CC)
A00-07-043	Pacific Gas & Electric - 2001 Attrition (California PUC)
T-01051B-99-0499	US West/Quest Broadband Asset Transfer (Arizona CC)
99-419/420	US West, Inc. Toll and Access Rebalancing (North Dakota PSC)
PU314-99-119	US West, Inc. Residential Rate Increase and Cost Study Review (North Dakota PSC)
98-0252	Ameritech - Illinois, Review of Alternative Regulation Plan (Illinois CUB)
00-108	Delmarva Billing System Investigation (Delaware PSC)
U-00-28	Matanuska Telephone Association (Alaska PUC)
Non-Docketed	Management Audit and Market Power Mitigation Analysis of the Merged Gas System Operation of Pacific Enterprises and Enova Corporation (California PUC)
00-11-038	Southern California Edison (California PUC)
00-11-056	Pacific Gas & Electric (California PUC)
00-10-028	The Utility Reform Network for Modification of Resolution E-3527 (California PUC)
98-479	Delmarva Power & Light Application for Approval of its Electric and Fuel Adjustments Costs (Delaware PSC)
99-457	Delaware Electric Cooperative Restructuring Filing (Delaware PSC)
99-582	Delmarva Power & Light dba Conectiv Power Delivery Analysis of Code of Conduct and Cost Accounting Manual (Delaware PSC)
99-03-04	United Illuminating Company Recovery of Stranded Costs (Connecticut OCC)
99-03-36	Connecticut Light & Power (Connecticut OCC)
Civil Action No.	
98-1117	West Penn Power Company vs. PA PUC (Pennsylvania PSC)
Case No. 12604	Upper Peninsula Power Company (Michigan AG)
Case No. 12613	Wisconsin Public Service Commission (Michigan AG)
41651	Northern Indiana Public Service Co Overearnings investigation (Indiana UCC)
13605-U	Savannah Electric & Power Company - FCR (Georgia PSC)
14000-U	Georgia Power Company Rate Case/M&S Review (Georgia PSC)
13196-U	Savannah Electric & Power Company Natural Gas Procurement and Risk Management/Hedging Proposal, Docket No. 13196-U (Georgia PSC)
Non-Docketed	Georgia Power Company & Savannah Electric & Power FPR Company Fuel Procurement Audit (Georgia PSC)
Non-Docketed	Transition Costs of Nevada Vertically Integrated Utilities (US Department of Navy)
Application No.	Post-Transition Ratemaking Mechanisms for the Electric Industry
99-01-016,	Restructuring (US Department of Navy)
Phase I	
99-02-05	Connecticut Light & Power (Connecticut OCC)
01-05-19-RE03	Yankee Gas Service Application for a Rate Increase, Phase I-2002-IERM (Connecticut OCC)
G-01551A-00-0309	Southwest Gas Corporation, Application to amend its rate Schedules (Arizona CC)
00-07-043	Pacific Gas & Electric Company Attrition & Application for a rate increase (California PUC)

97-12-020	Pacific Gas & Electric Company Rate Case (California PUC)
Phase II	United Illuminating Company (Connecticut OCC)
01-10-10	Georgia Power FCR (Georgia PSC)
13711-U	Verizon Delaware § 271(Delaware DPA)
02-001	Blue Valley Telephone Company Audit/General Rate Investigation (Kansas CC)
02-BLVT-377-AUD	S&T Telephone Cooperative Audit/General Rate Investigation (Kansas CC)
02-S&TT-390-AUD	Sunflower Telephone Company Inc., Audit/General Rate Investigation (Kansas CC)
01-SFLT-879-AUD	Bluestem Telephone Company, Inc. Audit/General Rate Investigation (Kansas CC)
01-BSTT-878-AUD	
P404, 407, 520, 413	
426, 427, 430, 421/	
CI-00-712	Sherburne County Rural Telephone Company, dba as Connections, Etc. (Minnesota DOC)
U-01-85	ACS of Alaska, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-34	ACS of Anchorage, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-83	ACS of Fairbanks, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-87	ACS of the Northland, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
96-324, Phase II	Verizon Delaware, Inc. UNE Rate Filing (Delaware PSC)
03-WHST-503-AUD	Wheat State Telephone Company (Kansas CC)
04-GNBT-130-AUD	Golden Belt Telephone Association (Kansas CC)
Docket 6914	Shoreham Telephone Company, Inc. (Vermont BPU)
Docket No.	
E-01345A-06-009	Arizona Public Service Company (Arizona Corporation Commission)
Case No.	
05-1278-E-PC-PW-42T	Appalachian Power Company and Wheeling Power Company both d/b/a American Electric Power (West Virginia PSC)
Docket No. 04-0113	Hawaiian Electric Company (Hawaii PUC)
Case No. U-14347	Consumers Energy Company (Michigan PSC)
Case No. 05-725-EL-UNC	Cincinnati Gas & Electric Company (PUC of Ohio)
Docket No. 21229-U	Savannah Electric & Power Company (Georgia PSC)
Docket No. 19142-U	Georgia Power Company (Georgia PSC)
Docket No.	
03-07-01RE01	Connecticut Light & Power Company (CT DPUC)
Docket No. 19042-U	Savannah Electric & Power Company (Georgia PSC)
Docket No. 2004-178-E	South Carolina Electric & Gas Company (South Carolina PSC)
Docket No. 03-07-02	Connecticut Light & Power Company (CT DPUC)
Docket No. EX02060363,	
Phases I&II	Rockland Electric Company (NJ BPU)
Docket No. U-00-88	ENSTAR Natural Gas Company and Alaska Pipeline Company (Regulatory Commission of Alaska)
Phase 1-2002 IERM,	
Docket No. U-02-075	Interior Telephone Company, Inc. (Regulatory Commission of Alaska)
Docket No. 05-SCNT-1048-AUD	South Central Telephone Company (Kansas CC)
Docket No. 05-TRCT-607-KSF	Tri-County Telephone Company (Kansas CC)
Docket No. 05-KOKT-060-AUD	Kan Okla Telephone Company (Kansas CC)
Docket No. 2002-747	Northland Telephone Company of Maine (Maine PUC)

Docket No. 2003-34	Sidney Telephone Company (Maine PUC)
Docket No. 2003-35	Maine Telephone Company (Maine PUC)
Docket No. 2003-36	China Telephone Company (Maine PUC)
Docket No. 2003-37	Standish Telephone Company (Maine PUC)
Docket Nos. U-04-022, U-04-023	Anchorage Water and Wastewater Utility (Regulatory Commission of Alaska)
Case 05-116-U/06-055-U	Entergy Arkansas, Inc. EFC (Arkansas Public Service Commission)
Case 04-137-U	Southwest Power Pool RTO (Arkansas Public Service Commission)
Case No. 7109/7160	Vermont Gas Systems (Department of Public Service)
Case No. ER-2006-0315	Empire District Electric Company (Missouri PSC)
Case No. ER-2006-0314	Kansas City Power & Light Company (Missouri PSC)
Docket No. U-05-043,44	Golden Heart Utilities/College Park Utilities (Regulatory Commission of Alaska)
A-122250F5000	Equitable Resources, Inc. and The Peoples Natural Gas Company, d/b/a Dominion Peoples (Pennsylvania PUC)
E-01345A-05-0816	Arizona Public Service Company (Arizona CC)
Docket No. 05-304	Delmarva Power & Light Company (Delaware PSC)
05-806-EL-UNC	Cincinnati Gas & Electric Company (Ohio PUC)
U-06-45	Anchorage Water Utility (Regulatory Commission of Alaska)
03-93-EL-ATA,	
06-1068-EL-UNC	Duke Energy Ohio (Ohio PUC)
PUE-2006-00065	Appalachian Power Company (Virginia Corporation Commission)
G-04204A-06-0463 et. al	UNS Gas, Inc. (Arizona CC)
U-06-134	Chugach Electric Association, Inc. (Regulatory Commission of Alaska)
Docket No. 2006-0386	Hawaiian Electric Company, Inc (Hawaii PUC)
E-01933A-07-0402	Tucson Electric Power Company (Arizona CC)
G-01551A-07-0504	Southwest Gas Corporation (Arizona CC)
Docket No. UE-072300	Puget Sound Energy, Inc. (Washington UTC)
PUE-2008-00009	Virginia-American Water Company (Virginia SCC)
PUE-2008-00046	Appalachian Power Company (Virginia SCC)
E-01345A-08-0172	Arizona Public Service Company (Arizona CC)
A-2008-2063737	Babcock & Brown Infrastructure Fund North America, LP. and The Peoples Natural Gas Company, d/b/a Dominion Peoples (Pennsylvania PUC)
08-1783-G-42T	Hope Gas, Inc., dba Dominion Hope (West Virginia PSC)
08-1761-G-PC	Hope Gas, Inc., dba Dominion Hope, Dominion Resources, Inc., and Peoples Hope Gas Companies (West Virginia PSC)
Docket No. 2008-0085	Hawaiian Electric Company, Inc. (Hawaii PUC)
Docket No. 2008-0266	Young Brothers, Limited (Hawaii PUC)
G-04024A-08-0571	UNS Gas, Inc. (Arizona CC)
Docket No. 09-29	Tidewater Utilities, Inc. (Delaware PSC)
Docket No. UE-090704	Puget Sound Energy, Inc. (Washington UTC)
09-0878-G-42T	Mountaineer Gas Company (West Virginia PSC)
2009-UA-0014	Mississippi Power Company (Mississippi PSC)
Docket No. 09-0319	Illinois-American Water Company (Illinois CC)
Docket No. 09-414	Delmarva Power & Light Company (Delaware PSC)
R-2009-2132019	Aqua Pennsylvania, Inc. (Pennsylvania PUC)
Docket Nos. U-09-069, U-09-070	ENSTAR Natural Gas Company (Regulatory Commission of Alaska)
Docket Nos. U-04-023, U-04-024	Anchorage Water and Wastewater Utility - Remand (Regulatory Commission of Alaska)
W-01303A-09-0343 & SW-01303A-09-0343	Arizona-American Water Company (Arizona CC)
09-872-EL-FAC & 09-873-EL-FAC	Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company - Audit I (Ohio PUC)

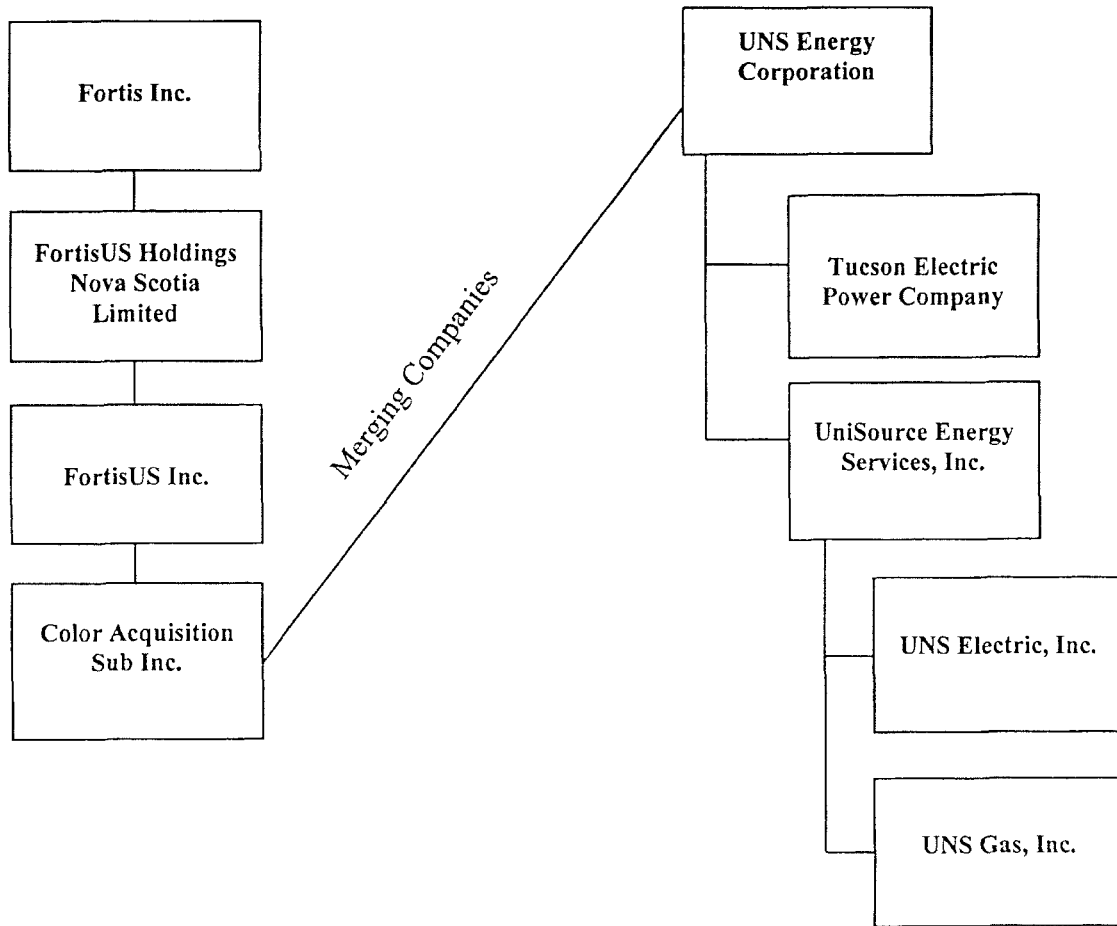
2010-00036	Kentucky-American Water Company (Kentucky PSC)
E-04100A-09-0496	Southwest Transmission Cooperative, Inc. (Arizona CC)
E-01773A-09-0496	Arizona Electric Power Cooperative, Inc. (Arizona CC)
R-2010-2166208,	
R-2010-2166210,	
R-2010-2166212, &	
R-2010-2166214	Pennsylvania-American Water Company (Pennsylvania PUC)
PSC Docket No. 09-0602	Central Illinois Light Company D/B/A AmerenCILCO; Central Illinois Public Service Company D/B/A AmerenCIPS; Illinois Power Company D/B/A AmerenIP (Illinois CC)
10-0713-E-PC	Allegheny Power and FirstEnergy Corp. (West Virginia PSC)
Docket No. 31958	Georgia Power Company (Georgia PSC)
Docket No. 10-0467	Commonwealth Edison Company (Illinois CC)
PSC Docket No. 10-237	Delmarva Power & Light Company (Delaware PSC)
U-10-51	Cook Inlet Natural Gas Storage Alaska, LLC (Regulatory Commission of Alaska)
10-0699-E-42T	Appalachian Power Company and Wheeling Power Company (West Virginia PSC)
10-0920-W-42T	West Virginia-American Water Company (West Virginia PSC)
A.10-07-007	California-American Water Company (California PUC)
A-2010-2210326	TWP Acquisition (Pennsylvania PUC)
08-1012-EL-FAC	Financial, Management, and Performance Audit of the FAC for Dayton Power and Light – Audit I (Ohio PUC)
10-268-EL FAC et al.	Financial Audit of the FAC of the Columbus Southern Power Company and the Ohio Power Company – Audit II (Ohio PUC)
Docket No. 2010-0080	Hawaiian Electric Company, Inc. (Hawaii PUC)
G-01551A-10-0458	Southwest Gas Corporation (Arizona CC)
10-KCPE-415-RTS	Kansas City Power & Light Company – Remand (Kansas CC)
PUE-2011-00037	Virginia Appalachian Power Company (Commonwealth of Virginia SCC)
R-2011-2232243	Pennsylvania-American Water (Pennsylvania PUC)
U-11-100	Power Purchase Agreement between Chugach Association, Inc. and Fire Island Wind, LLC (Regulatory Commission of Alaska)
A.10-12-005	San Diego Gas & Electric Company (California PUC)
PSC Docket No. 11-207	Artesian Water Company, Inc. (Delaware PSC)
Cause No. 44022	Indiana-American Water Company, Inc. (Indiana Utility Regulatory Commission)
PSC Docket No. 10-247	Management Audit of Tidewater Utilities, Inc. Affiliate Transactions (Delaware Public Service Commission)
G-04204A-11-0158	UNS Gas, Inc. (Arizona Corporation Commission)
E-01345A-11-0224	Arizona Public Service Company (Arizona CC)
UE-111048 & UE-11049	Puget Sound Energy, Inc. (Washington Utilities and Transportation Commission)
Docket No. 11-0721	Commonwealth Edison Company (Illinois CC)
11AL-947E	Public Service Company of Colorado (Colorado PSC)
U-11-77 & U-11-78	Golden Heart Utilities, Inc. and College Utilities Corporation (The Regulatory Commission of Alaska)
Docket No. 11-0767	Illinois-American Water Company (Illinois CC)
PSC Docket No. 11-397	Tidewater Utilities, Inc. (Delaware PSC)
Cause No. 44075	Indiana Michigan Power Company (Indiana Utility Regulatory Commission)
Docket No. 12-0001	Ameren Illinois Company (Illinois CC)
11-5730-EL-FAC	Financial, Management, and Performance Audit of the FAC for Dayton Power and Light – Audit 2 (Ohio PUC)
PSC Docket No. 11-528	Delmarva Power & Light Company (Delaware PSC)
11-281-EL FAC et al.	Financial Audit of the FAC of the Columbus Southern Power Company and the Ohio Power Company – Audit III (Ohio PUC)
Cause No. 43114-IGCC-	

4S1	Duke Energy Indiana, Inc. (Indiana Utility Regulatory Commission)
Docket No. 12-0293	Ameren Illinois Company (Illinois CC)
Docket No. 12-0321	Commonwealth Edison Company (Illinois CC)
12-02019 & 12-04005	Southwest Gas Corporation (Public Utilities Commission of Nevada)
Docket No. 2012-218-E	South Carolina Electric & Gas (South Carolina PSC)
Docket No. E-72, Sub 479	Dominion North Carolina Power (North Carolina Utilities Commission)
12-0511 & 12-0512	North Shore Gas Company and The Peoples Gas Light and Coke Company (Illinois CC)
E-01933A-12-0291	Tucson Electric Power Company (Arizona CC)
Case No. 9311	Potomac Electric Power Company (Maryland PSC)
Cause No. 43114-IGCC-10	Duke Energy Indiana, Inc. (Indiana Utility Regulatory Commission)
Docket No. 36498	Georgia Power Company (Georgia PSC)
Case No. 9316	Columbia Gas of Maryland, Inc. (Maryland PSC)
Docket No. 13-0192	Ameren Illinois Company (Illinois CC)
12-1649-W-42T	West Virginia-American Water Company (West Virginia PSC)
E-04204A-12-0504	UNS Electric, Inc. (Arizona CC)
PUE-2013-00020	Virginia and Electric Power Company (Virginia SCC)
R-2013-2355276	Pennsylvania-American Water Company (Pennsylvania PUC)
Formal Case No. 1103	Potomac Electric Power Company (District of Columbia PSC)
U-13-007	Chugach Electrical Association, Inc. (The Regulatory Commission of Alaska)
12-2881-EL-FAC	Financial, Management, and Performance Audit of the FAC for Dayton Power and Light – Audit 3 (Ohio PUC)
Docket No. 36989	Georgia Power Company (Georgia PSC)
Cause No. 43114-IGCC-11	Duke Energy Indiana, Inc. (Indiana Utility Regulatory Commission)
UM 1633	Investigation into Treatment of Pension Costs in Utility Rates (Oregon PUC)

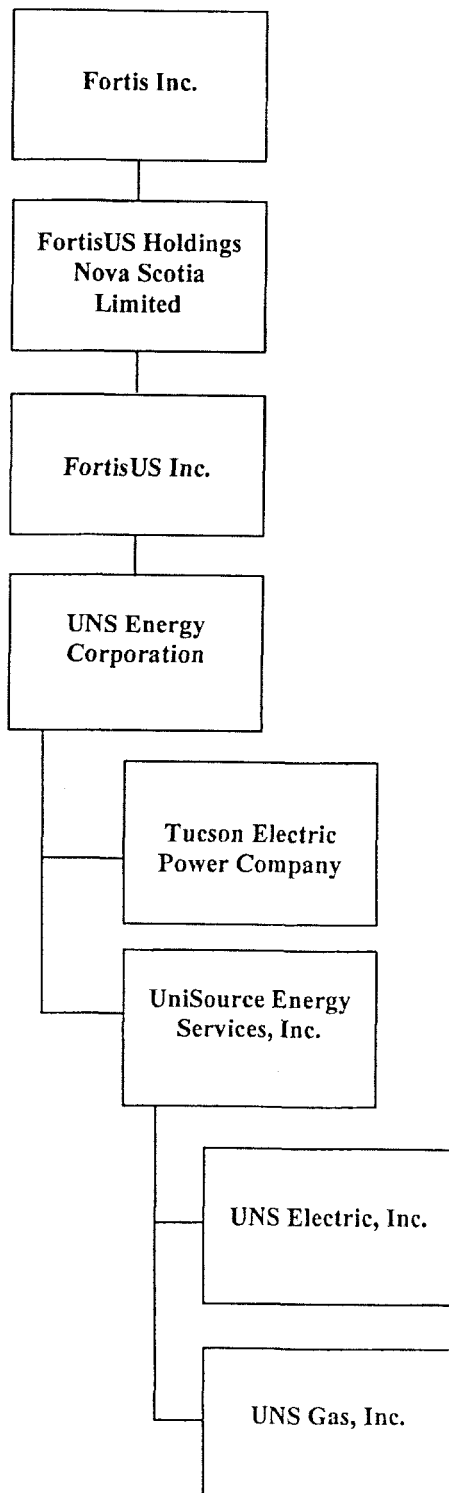
Attachment RCS-2

Pre- and Post-Acquisition Corporate Organizational Chart  
(From Joint Application Exhibit 2 and  
UNS Energy Testimony Exhibit DGH-2)

## Pre-Merger



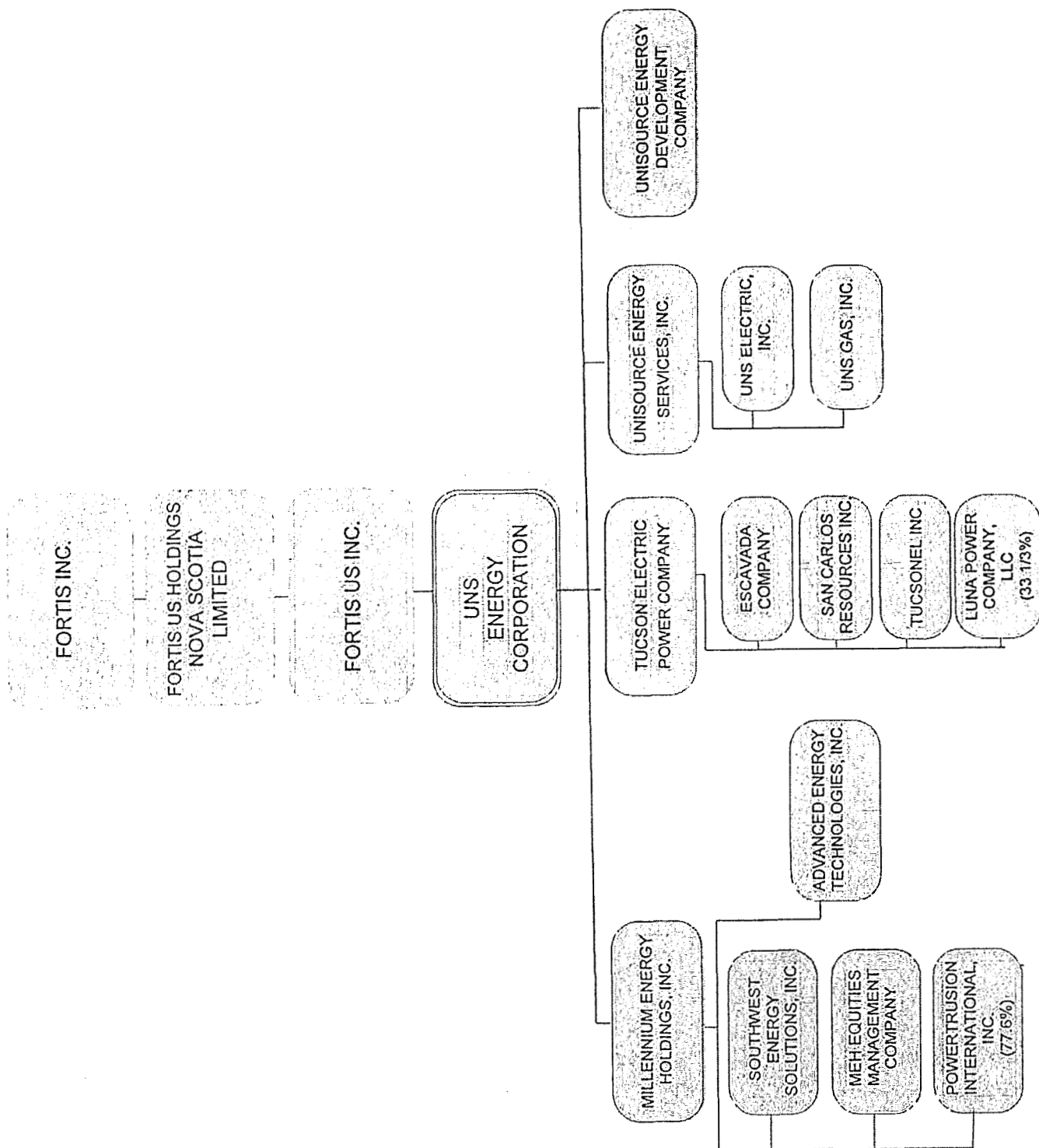
## Post-Merger





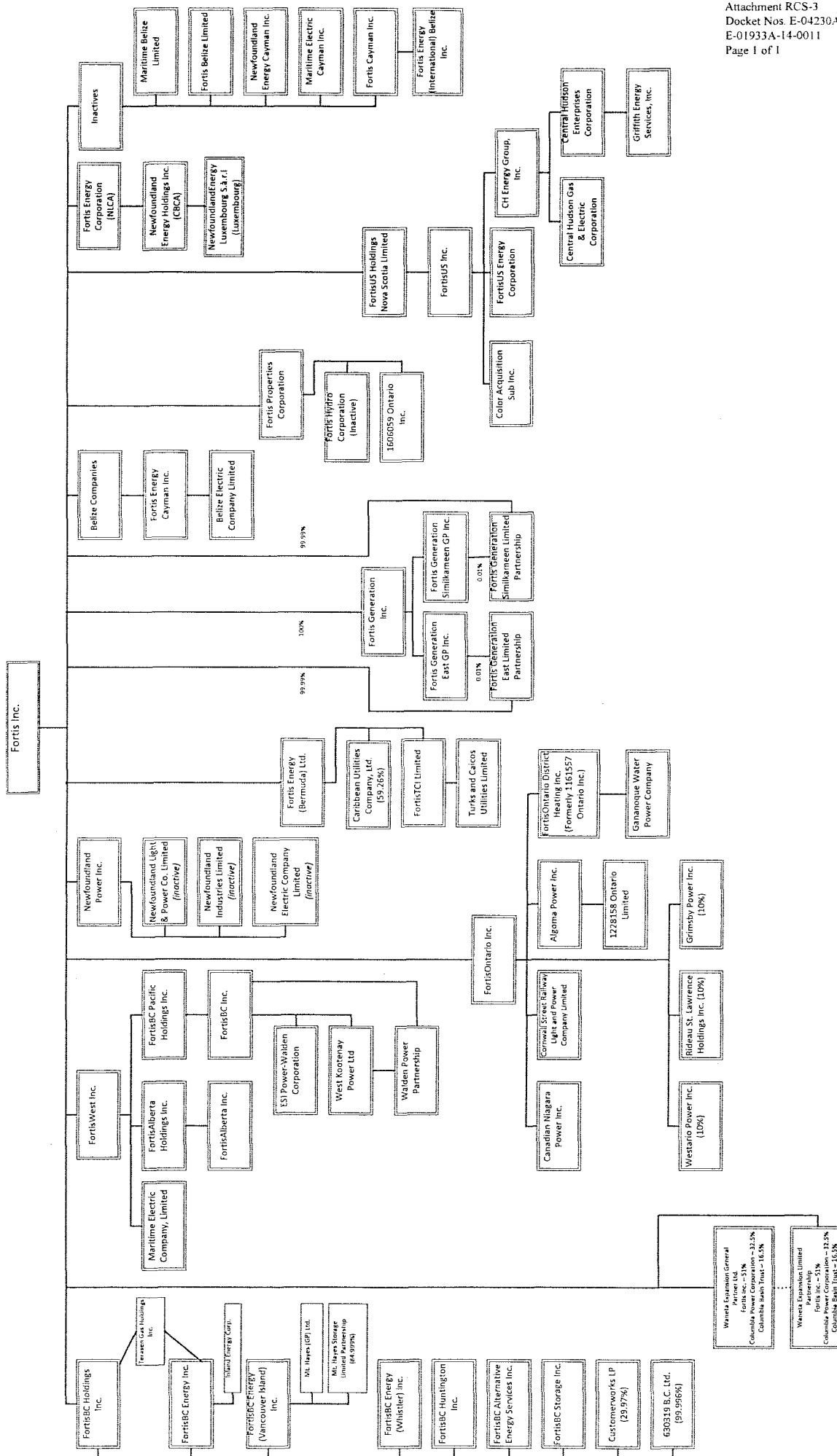
# UNS Energy Corporation & Subsidiaries

Post Merger



Attachment RCS-3

Fortis Inc. Organizational Chart as of February 2014  
(From Email dated March 26, 2014)



**UNS Energy Corporation and Fortis Inc.  
Docket Nos. E-04230A-14-0011 and E-01933A-14-0011**

**Attachment RCS-4**

**Recent News Articles on Energy Future Holdings' Impending Bankruptcy  
and Information Illustrating Large Historical Goodwill Impairment Write-offs  
Following Acquisition/Merger Transactions**

<b>Article</b>	<b>No. of Pages</b>	<b>Page No.</b>
Dallas Business Journal - "Drama continues for EFH; new anonymous bonds buyer in the mix", April 14, 2014	2	2 - 3
Bloomberg Businessweek - "Energy Future Holdings misses filing deadline", April 15, 2014	2	4 - 5
Star-Telegram - "Energy Future Holdings bankruptcy would likely attract bidders for Oncor", April 17, 2014	2	6 - 7
Star-Telegram - "Energy Future Holdings files Chapter 11 bankruptcy", April 29, 2014	2	8 - 9
"Qwest Takes \$41 Billion Impairment Hit", October 29, 2002	1	10
"What AOL Time Warner's \$54 Billion [Goodwill Impairment] Loss Means", April 25, 2002	2	11 - 12
Scottish Power 922 million (British pounds) 2006 Goodwill Impairment related to their discontinued PacifiCorp Operations	1	13
Exelon Goodwill Impairment charge of \$776 million for ComEd after Illinois Commerce Commission decision in 2005 ComEd rate case	1	14
Total Pages Including this Page	14	

From the Dallas Business Journal

:[http://www.bizjournals.com/dallas/blog/morning\\_call/2014/04/drama-continues-for-efh-new-anonymous-bonds-buyer.html](http://www.bizjournals.com/dallas/blog/morning_call/2014/04/drama-continues-for-efh-new-anonymous-bonds-buyer.html)

Apr 14, 2014, 5:27am CDT

## Drama continues for EFH; new anonymous bonds buyer in the mix



Nicholas Sakelaris

Staff Writer- *Dallas Business Journal*

[Email](#) | [LinkedIn](#) | [Twitter](#) | [Google+](#)

Despite Energy Future Holdings' massive debt load and inevitable bankruptcy, the power giant's Oncor subsidiary saw the price of 2018 bonds go up 9 cents last week, Bloomberg reported.

The \$1.57 billion in bonds due December, 2018 went from 72.4 cents April 4 to 81.6 cents on April 10, Bloomberg calculated.

One anonymous buyer of those bonds submitted a so-called "Big Boy Letter" last week that, according to Bloomberg sources, indicates the buyer could have non-public information and could be a party in the pre-bankruptcy negotiations.

The clock is ticking for Dallas-based EFH because the company skipped a \$109 million interest payment that was due April 1, giving the company until April 30 to reach a pre-packaged bankruptcy or face the wrath of scorned creditors.

EFH started as a leveraged buyout in 2007 as a gamble that natural gas prices would rise, sending the price of wholesale electricity up with it. Hydraulic fracturing and horizontal drilling techniques made shale gas accessible to the point where it flooded the market, dropping the price. That sent EFH into a downward spiral.

So what happens when the company that generates, sells and delivers electricity throughout North Texas goes bankrupt and why is Oncor being treated differently?

Attachment RCS-4

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The cover story for the most recent *Dallas Business Journal* explores the five ways of looking at the looming failure of EFH and what caused the largest leveraged buyout in history to turn into what will be one of the largest bankruptcies in history.

Nicholas covers the energy and banking beats for the Dallas Business Journal. Subscribe the Energy Inc. newsletter

Bloomberg Businessweek

## News

<http://www.businessweek.com/ap/2014-04-15/energy-future-holdings-misses-filing-deadline>

# Energy Future Holdings misses filing deadline

By Emily Schmall April 15, 2014

FORT WORTH, Texas (AP) — Energy Future Holdings is still not ready to file its already delayed annual report, the company said in a filing Tuesday with the federal Securities and Exchange Commission.

The decision not to submit the report places the Dallas-based company in breach of agreements with creditors for TXU Energy and Luminant, the largest power generator in Texas, and could be another step towards bankruptcy.

Two weeks ago, Energy Future Holdings skipped a deadline to pay \$109 million in interest payments, relying upon a 30-day grace period to avoid a default. Companies have 90 days from the end of the year to file their annual reports. Energy Future asked for a two-week extension on April 1.

The Sierra Club and other environmental watchdogs have said the company's looming bankruptcy could jeopardize nearly \$1 billion in mining cleanup funds owed to Texas.

Luminant Mining Co. has been allowed to operate without a reserve fund to restore the heavily mined areas in East Texas where it operates, but Energy Future spokesman Allan Koenig insisted environmental reclamations will be paid, no matter the outcome.

"This is a financial, rather than operational, issue. There is no chance the plants will shut down," Koenig said.

In an April 1 filing, Energy Future said it expects to have the financing to permit Luminant to grant the Texas Railroad Commission a collateral bond equal to or beyond what it owes for the cleanup.

Still, the Texas Railroad Commission, which regulates the state's oil and gas industries, said this week that it will require Luminant to post real cash bonds to cover future mining operations when and if Energy Future files and emerges from its Chapter 11 bankruptcy protection.

There is no set date for a bankruptcy to commence as negotiations over the company's \$45.6 billion debt continue among Energy Future's owners, management and holders, according to Koenig. However, the company could issue a warning about its ability to continue as a going concern or fail to pay interest due by the end of April, either of which would trigger a default.

The company had bet that natural gas prices would rise, giving its coal-fired plants a competitive edge. Instead, natural gas prices have plummeted amid a glut of production from U.S. shale deposits.

Attachment RCS-4

Energy Future Holdings was acquired in 2007 by private-equity firms KKR & Co., TPG Capital and Goldman Sachs Capital Partners.

Page 5 of 14

The proposal stakeholders are now discussing aims to reduce the amount of time it takes to restructure, avoiding a chaotic free-for-all and protect stakeholders from a tax liability estimated at as much as \$7 billion that could be triggered if the company fails to keep its regulated and deregulated units intact.

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# Star-Telegram

## Energy Future Holdings bankruptcy would likely attract bidders for Oncor

Posted Thursday, Apr. 17, 2014

BY MARK CHEDIAK

Bloomberg News

The expected bankruptcy filing by Dallas-based Energy Future Holdings, created through the biggest leveraged buyout in history, is poised to put the most profitable unit of the power producer up for grabs.

Oncor Electric Delivery, which operates most of the power lines serving North Texas, may eventually end up in the hands of creditors, who could sell it to a utility buyer if EFH is broken up during bankruptcy, according to debt researchers Gimme Credit and CreditSights.

MidAmerican Energy Holdings, owned by Warren Buffett's Berkshire Hathaway; Houston-based CenterPoint Energy; Exelon; and American Electric Power may jump at the chance to bid for the operator of the largest transmission and distribution system in Texas, said Moody's Investors Service. Oncor may be the most-coveted unit because of its regulated, steady earnings.

Energy Future's two other big units — Luminant Generation, the state's largest power producer, and TXU Energy, a big electricity retailer — are deregulated.

KKR, Goldman Sachs Capital Partners and TPG Capital bought out the former TXU Corp. in 2007 with tens of billions in borrowed dollars, hoping that the deregulated electricity market, high power prices and steady growth would prove a winning investment. But falling natural gas prices led to lower electricity prices, eroding EFH's ability to generate enough money to pay down the loans.

It now owes about \$45 billion in debt. EFH owns about 80 percent of Oncor, having sold the rest shortly after the buyout to raise cash.

"We view Oncor as a premium asset," said Jim Hempstead, a New York-based analyst at Moody's. "The list of interested buyers would probably be as long as a West Texas country mile."

EFH, now in a 30-day grace period of a missed interest payment that was due April 1, is widely expected to file a Chapter 11 bankruptcy petition this month.

Oncor, which provides electricity to more than 3 million homes and businesses, "recovered faster from the recession than anyone else and is one of the few utilities reporting actual customer growth," said Dot Matthews, a New York-based analyst who covers the utility for CreditSights. "They have remained a stable, good investment."

Allan Koenig, a spokesman for Energy Future Holdings, declined to comment.

Although creditors would take majority ownership of Oncor in the restructuring, they would probably want to sell it eventually instead of holding it for dividend payments that are capped by regulators, said Philip Adams, a credit analyst for Gimme Credit. A buyer could also bid for the other 20 percent not owned by EFH, he said.

Oncor's steady return and growth potential could make it a target for a number of investor-owned utilities, including MidAmerican Energy, said Timothy Winter, an analyst for Gabelli & Co.

Oncor is allowed about a 10 percent return on its investments by regulators and said in February that it plans to spend \$1 billion annually over the next five years as it upgrades its power line network to meet increasing demand.

Net income at the utility increased 24 percent last year to \$432 million, according to a February filing.

Attachment RCS-4

Page 7 of 14

Oncor could appeal to Exelon, which has expressed interest in expanding in Texas, said Julien Dumoulin-Smith, a New York-based analyst with UBS AG.

Representatives for MidAmerican and Exelon declined to comment.

Looking for comments :

## Energy Future Holdings files for Chapter 11 bankruptcy

Posted Tuesday, Apr. 22, 2014

By Jim Fuquay and Steve Kaskovich

jfuquay@star-telegram.com

Dallas-based Energy Future Holdings filed for Chapter 11 bankruptcy protection early today after reaching a deal with creditors that calls for breaking off its power generation and retail arms in exchange for reducing debt. The bankruptcy petition was filed in Delaware.

The state's largest power company, formed in 2007 with the \$45 billion buyout of the former TXU Corp. led by KKR, Texas Pacific Group and Goldman Sachs, has been struggling under the weight of \$40 billion in debt as its revenues have plunged with lower prices for natural gas and electricity.

Under terms of the proposed restructuring agreement, Texas Competitive Electric Holdings — which includes the company's unregulated power company Luminant Generation and retail provider TXU Energy — would be transferred to its first lien lenders in a deal that would eliminate approximately \$23 billion of its debt, the company said in a news release. Luminant is the state's largest power generator. TXU Energy is Texas' biggest electricity retailer, with more than 1.5 million customers.

Energy Future Intermediate Holdings, which owns 80 percent of Oncor Electric Delivery, will remain part of Energy Future Holdings, although creditors would gain an unspecified stake in the unit under a proposal that calls for a new debt structure. Oncor, a regulated utility that operates the power lines serving much of North Texas, is not part of the bankruptcy filing.

"We are pleased to have the support of our key financial stakeholders for a consensual restructuring," said John Young, president and chief executive officer of Energy Future Holdings, in a prepared statement. "This restructuring is focused on our balance sheet, not our operations. We fully expect to continue normal business operations during the reorganization."

EFH said it expects to file its plan of reorganization "in the near term." It said it hopes to have a confirmed reorganization plans within nine months and to exit from its Chapter 11 proceeding in 11 months.

The Electric Reliability Council of Texas, the state's largest power grid, said it and state regulators have "been monitoring this situation. Prior to this filing, ERCOT has communicated, as necessary, with the affected Energy Future Holdings Corp. subsidiaries that operate in the ERCOT market to address any concerns that could impact system reliability or the efficiency of the market."

While the bankruptcy filing has been anticipated for more than a year, EFH's circumstances were particularly urgent now.

Thursday marks the expiration of the grace period on more than \$100 million in debt payments that EFH skipped a month earlier. It also delayed filing its annual financial report, which is expected to contain a report from its auditors that would put the company in default.

EFH had been trying to reach a deal with its major creditors to prevent a free-for-all that could draw out the bankruptcy proceeding. Moody's Investors Service last year estimated that the Texas Competitive Electric unit has roughly \$30 billion in debt but is only worth about \$15 billion.

KKR, TPG, Goldman Sachs and their investors, which put a total of \$8.3 billion into the buyout, are expected to lose all or nearly all that money.

The purpose of a Chapter 11 reorganization is to give a company relief from debt repayment while it restructures its finances into a more sustainable form. EFH said Tuesday it arranged up to \$4.5 billion in new loans for Texas Competitive Electric Holdings and \$7.3 billion for Energy Future Intermediate Holdings.

Loans extended to a company after it files for bankruptcy are senior to debt accumulated before the filing.

"Our existing capital structure has become unsustainable," Young said in the statement. "We expect that, with the support of our financial stakeholders, our restructuring can proceed expeditiously as we seek to strengthen our balance sheet and position the company for the future."

### Long slide toward bankruptcy

Here are financial results for Energy Future Holdings starting in 2007, the last year before it was created with the buyout of TXU Corp. (all amounts in billions)

Year	Revenues	Income (loss)	Long-term debt
2007	\$12.0	\$2.55	\$12.0
2007	\$10.0	(\$0.37)	\$38.0
2008	\$11.4	(\$1.8)	\$40.8
2009	\$15	\$0.344	\$41.4
2010	\$8.2	(\$2.8)	\$34.2
2011	\$7.0	(\$1.0)	\$35.4
2012	\$5.0	(\$3.4)	\$37.8
2013	\$4.0	(\$0.35)	\$38.1

As of June 30

Jim Fuquay, 817-390-7552 Twitter: @jimfuquay

Read more here <http://www.star-telegram.com/2014/04/28/577413/energy-future-holdings-prepares.html?storylink=cpy>



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## Reverse Charge: Qwest Takes \$41 Billion Impairment Hit

FAS 142 strikes again; troubled telco will also restate \$531 million in revenues. Elsewhere: Sarbanes-Oxley could shrink Big Four tax business, blue chips going long, and did IT pay go up or down last year?

[Stephen Taub](#), CFO.com | US  
October 29, 2002

The feeding frenzy of the late Nineties is starting to catch up to Corporate America.

Yesterday, Qwest Communications International Inc. became the latest company to write down the value of its past acquisitions. Management at the troubled telecom company said Qwest will report goodwill impairment charges totaling as much as \$40.8 billion by the end of the year.

That's a big phone bill. In fact, the writeoff works out to more than half of Qwest's \$74 billion in assets.

Earlier this year, media giant AOL Time Warner took a record \$54 billion charge to write off goodwill to reflect the sharp decline in the value of its \$106.2 billion purchase of Time Warner in 2000.

And last week, AOL warned it will probably report "a substantial overall goodwill impairment" when it completes its impairment analysis under FAS 142 at the end of the fourth quarter.

Here's how Qwest arrived at the \$40.8 figure.

Company management had already said it expects to report a goodwill impairment charge of approximately \$24 billion as of January 1, 2002, the effective date of FAS 142.

On Monday, however, Qwest management said that other factors (such as the business conditions in the telecom industry and the company's market capitalization during 2002) may result in an additional impairment of \$6 billion of goodwill. The company has about 29 million customers in the U.S.

Qwest will also record an \$8.1 billion impairment charge for the second quarter of 2002 to write-down the recoverability of the long-lived assets of its traditional telephone network, global fiber optic broadband network, and related assets.

The telco also figures to take about an \$2.7 billion reduction in the carrying value of intangible assets related to customer lists and product technology associated with the company's interexchange carrier business.

In yesterday's announcement, Qwest management also indicated it would restate \$531 million of revenues. In explaining the restatement, the telco's management noted that Qwest's policies and practices for determining the value of the various elements of the fees earned in connection with the sales of optical capacity assets did not support the accounting treatment. Qwest recorded a net loss of about \$4 billion in 2001.

The company added the announcement relates to optical capacity asset transactions recorded in periods following the merger of Qwest and US West, Inc. on June 30, 2000.

As CFO.com reported in late July, Qwest said it may restate the company's results for 1999, 2000 and 2001 in connection with sales of optical capacity assets. Qwest management said at the time it misapplied about \$1.16 billion in optical capacity sales.

And back in March, CFO.com also reported that the SEC was investigating Qwest's accounting policies, practices, and procedures for 2000 and 2001.

The Justice Department and Congress are currently investigating Qwest.

TIME

Thursday, Apr. 25, 2002

## What AOL Time Warner's \$54 Billion Loss Means

By Frank Pellegrini

Sticking out of AOL Time Warner's rather humdrum earnings report Wednesday was a very gaudy number: A one-time loss of \$54 billion. It's the largest spill of red ink, dollar for dollar, in U.S. corporate history and nearly two-thirds of the company's current stock-market value. (It's also, as a lot of news outlets have noted, more than the annual GDP of Ecuador, but that's hardly relevant here.) All for something called "goodwill impairment."

Sound like an awful lot of money to give to charity? In Wall Street's euphemism-speak, goodwill is more like getting taken to the cleaners. "Goodwill" is the term for the premium one company pays to acquire another, over and above the acquired company's book value. Such overpayment is intentional, whether to beat out fellow suitors or woo the shareholders of the bride, and technically it's an asset (albeit an intangible one), the assumption being that all that extra dough was buying *something*.

Now "goodwill impairment" —that's when that extra millions (or billions) in the purchase price turns out to have wasted, when it becomes apparent that the value of the merged company not only isn't *more* than the original buyer thought it was worth, but a whole lot less. Such losses in actual value used to be quietly swept under the rug, amortized away over the course of as much as 40 years.

But this year the rules have changed. The Financial Accounting Standards Board (yes, there actually standards in accounting) has decreed this year that companies must test their goodwill assets for "impairment" annually —and when they find some, they've got to fess up. And while AOL Time Warner's number may be the biggest (just topping JDS Uniphase's write-down last year of just over \$50 billion), the media giant (and corporate overlord of this writer) isn't standing alone. A recent Bear Stearns study anticipates that some 500 companies are candidates for write-downs this year, with perhaps a dozen in the billion-dollar club.

Why so many? Call it a bunch of drunken sailors nursing a hangover. When AOL and Time Warner first decided to merge, the dot-com love affair was raging and the stock of the combined companies was worth \$290 billion, mostly thanks to the price of AOL. By the time the stock-swap deal closed a year later, the bubble had burst, AOL was back on earth, and even though AOL had technically been the acquirer (thanks to that high stock price), the new AOL Time Warner suddenly had a relative lemon on its hands.

The new rule was originally going to require companies to post such losses as a relevant part of its continuing operations — which is hard to argue with when the asset is in the company's name — but businesses successfully lobbied to have the losses classified under "cumulative effects of changes in accounting principles." And now, even though they've got the rest of the year to do it, many companies are looking to get it out of the way while their excuse — the rule change — is still fresh in investors' minds.

And so Qwest Communications, which acquired the former U.S. West in 2000 only to find a year later that Qwest itself was the overvalued asset, recently predicted a second-quarter goodwill write-down of \$20 billion to \$30 billion. Blockbuster on Wednesday logged its own loss of \$1.82 billion. And the parade is just beginning — future candidates include WorldCom, which lists \$50 billion in potentially-impaired goodwill but is only worth \$42.7 billion in the market, and AT&T, still sporting \$24.8 billion of goodwill from its hostile takeover of MediaOne in 1999. (Notice a lot of tech and telecom companies?)

Investors generally ignore the bad news, either because they'd seen it coming — AOL Time Warner telegraphed its loss weeks ago — and because nearly every survivor of the tech bust has a few embarrassing purchases to own up to. Besides, AOL Time Warner's shares are down 41 percent this year alone, thanks to investors doing their own writing-down of AOL's value (with most analysts pegging it at about \$1 a share on top of Time Warner's assets). So the \$54 billion loss — and the total \$1 trillion in goodwill-impairment writedowns that some analysts expect to hit Wall Street this year — is merely an acknowledgement of what investors have already figured out.

Still, a mistake is a mistake, and some analysts insist that while such write-downs are paper losses, it would be a mistake to ignore them completely — particularly if the company's stock hasn't already taken the appropriate hit. And even if it has, a company that runs around overpaying for assets that don't perform — even if it's only overpaying because investors were fooled too — is one to keep a jaundiced eye on.

Remember, the fall of Enron started with a one-time write-down. And there's not a lot of goodwill left at *that* company any more.

Scottish Power 2006 goodwill impairment  
May 24, 2006, 2:30 a.m. EDT

Scottish Power swings to fiscal year net profit

LONDON (MarketWatch) -- Electricity company Scottish Power said Wednesday that it swung to a fiscal 2006 net profit of 1.5 billion pounds (\$2.8 billion), or 83.15 pence a share, after good growth from all its businesses. Last year, the company produced a loss of 188.7 million pounds after taking a 922 million pound exceptional charge related to goodwill impairment at its now discontinued PacifiCorp operations. On an adjusted basis, pretax profit rose 47% to 675 million pounds, ahead of the 655 million pound figure expected by analysts. The company said that it is confident that it will continue to make significant progress and create value for shareholders.



Exelon Corporation and Subsidiary Companies  
Exelon Generation Company, LLC and Subsidiary Companies  
Commonwealth Edison Company and Subsidiary Companies  
PECO Energy Company and Subsidiary Companies

Combined Notes to Consolidated Financial Statements—(Continued)  
(Dollars in millions, except per share data unless otherwise noted)

Exelon assesses goodwill impairment at its ComEd reporting unit. Accordingly, any goodwill impairment charge at ComEd will affect Exelon's consolidated results of operations. In estimating the fair value of ComEd, Exelon and ComEd used a probability-weighted, discounted cash flow model with multiple scenarios. The determination of the fair value was dependent on many sensitive, interrelated and uncertain variables including changing interest rates, utility sector market performance, capital structure, rate regulatory structures, operating and capital expenditure requirements and other factors. Changes in the variables used in the impairment review could possibly result in a future impairment loss of ComEd's goodwill, which could be material.

2006 Interim Goodwill Impairment Assessment. Due to the significant negative impact of the ICC's July 2006 order in ComEd's 2005 Rate Case to the cash flows and value of ComEd, an interim impairment assessment was completed during the third quarter of 2006. Based on the results of this interim goodwill impairment analysis, which was performed using the same model and assumptions discussed above, Exelon and ComEd recorded a charge of \$776 million associated with the impairment of goodwill during the third quarter of 2006. See Note 4—Regulatory Issues for further information regarding the 2005 Rate Case.

UNS Energy Corporation and Fortis Inc.  
Docket Nos. E-04230A-14-0011 and E-01933A-14-0011  
Attachment RCS-5  
Copies of UNS Energy and Fortis Inc.'s Non-Confidential Responses to Data Requests  
and Documents Referenced in the Direct Testimony of  
Ralph C. Smith

Data Request/ Worksheet No.	Subject	Confidential	No. of Pages	Page No.
RUCO Fortis 2.05	Estimated amount of Goodwill Fortis expects to record if the acquisition is approved, related journal entries, and description of how Fortis tests for Goodwill impairment.	No	9	2 - 10
UDR 1.37	Joint Applicants confirm that, per stipulated condition No. 5 included in the Joint Notice of Intent to Reorganize, TEP, UNS Gas and UNS Electric will not seek rate recovery of any premium to be paid by Fortis for UNS Energy common stock or any transaction cost associated with the acquisition.	No	1	11
RUCO Fortis 1.04	Description of terms and conditions to Fortis-CH Hudson acquisition in Case No. 12-M-0192, from New York Public Service Commission order dated June 26, 2013 (includes Attachment A, which contains the NY PSC required Terms and Conditions).	No	23	12 - 34
UDR 1.36	Anticipated cost savings include reduced or eliminated public company costs, reduced insurance costs, and a potentially lower cost of debt as the result of anticipated credit rating upgrades.	No	1	35
RUCO Fortis 2.09	Treatment of shareholder litigation costs charged to UNS subsidiaries. Fortis agrees that none of the costs of shareholder litigation should be borne by the customers of TEP, UNS Electric or UNS Gas.	No	2	36 - 37
UDR 1.33	Description of the nature and status of litigation related to the acquisition.	No	2	38 - 39
RUCO UNS 1.02	No Internal Revenue Code §338(h)(10) elections will be made with the acquisition.	No	1	40
UDR 1.08	UNS Gas' current bond rating	No	1	41
UDR 1.09	UNS Electric's current bond rating	No	1	42
UDR 1.10	TEP's current bond ratings	No	1	43
UDR 1.11	UNS Energy's current bond rating	No	1	44
UDR 1.16	Fortis Inc.'s current bond/debt ratings (including attachments)	No	19	45 - 63
UDR 1.30	Changes to the cost of debt for TEP, UNS Gas and UNS Electric anticipated to result from the transaction	No	1	64
UDR 1.31	Pre-acquisition and post-acquisition consolidated capital structure of UNS Energy	No	1	65
UDR 1.32	UNS Energy will issue no debt in connection with the merger but may issue short term debt to finance the purchase of Gila River Unit 3 and for TEP to purchase a portion of Springerville Unit 1	No	1	66
RUCO UNS 2.07	Status of TEP's investigation of plans to sell coal for Springerville Units 1 and 2 to a third party and buy-back treated coal for burn at Springerville Units 1 and 2 so IRS Section 45 credits can be generated; TEP's anticipated net reductions of coal cost during years 2014-2018; TEP's accounting for the anticipated reductions; TEP assurance that the benefits will be passed on to the ratepayers through the PPFAC.	No	2	67 - 68
RUCO UNS 2.08	Neither TEP nor UNS has provided information to Fortis about an arrangement with a third party to generate Section 45 credits for the period of 2014-2018.	No	1	69
RUCO Fortis 2.02	Explanation by Fortis of why the use of an overseas conduit entity as part of the anticipated financing was not specifically disclosed in Fortis' application and prefiled testimony.	No	1	70
RUCO Fortis 2.01	Organizational chart of the proposed Fortis structure including Luxembourg conduit affiliates.	No	2	71 - 72
RUCO Fortis 2.04	Anticipated amount of intercompany debt Fortis will use to finance the acquisition and the entities Fortis intends to use for that purpose as an integrated part of its financing and dividend repatriation plan.	No	3	73 - 75
RUCO Fortis 2.16	Explanation of how important being accretive to earnings is to Fortis in pursuing the acquisition of UNS Energy.	No	1	76
RUCO Fortis 1.05	Fortis-CH Hudson acquisition ratepayer benefits and information on the relative size of the Central Hudson utilities.	No	6	77 - 82
RUCO Fortis 2.29	Anticipated impact of merger on increased Fortis corporate costs, and how the increased Fortis corporate costs will be charged to the Arizona utilities. (includes Attachment 1 only)	No	4	83 - 86
UDR 1.14	Methodology used by UNS Energy to allocate costs to its subsidiaries.	No	1	87
RUCO Fortis 2.08	Fortis' intentions to seek other utility acquisitions.	No	1	88
	Cover and page K-101 from UNS Energy Corporation SEC Form 10-K for the fiscal year ending December 31, 2013 showing 2013 Operating Revenues for reportable business segments TEP, UNS Electric, and UNS Gas.	No	2	89 - 90
Total Pages Including this Page			90	

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.05**

The Fortis Inc. 2013 Annual Report states at pages 88-89:

"Goodwill represents the excess, at the dates of acquisition, of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired and liabilities assumed relating to business acquisitions. Goodwill is carried at initial cost less any write-down for impairment.

"Fortis performs an annual internal quantitative assessment for each reporting unit and, for those reporting units where: (i) management's assessment of quantitative and qualitative factors indicates that fair value is not 50% or more likely to be greater than carrying value; or (ii) where the excess of estimated fair value over carrying value, as determined by an independent external consultant as of the date of the immediately preceding impairment test, was not significant, then fair value of the reporting unit will be estimated by an independent external consultant in the current year. Irrespective of the above-noted approach, a reporting unit to which goodwill has been allocated may have its fair value estimated by an independent external consultant as at the annual impairment date, as Fortis will, at a minimum, have fair value for each reporting unit estimated by an independent external consultant once every three years. Fortis performs the annual impairment test as at October 1. In addition, the Corporation also performs an impairment test if any event occurs or if circumstances change that would indicate that the fair value of a reporting unit is below its carrying value. No such event or change in circumstances occurred during 2013 or 2012 and no impairment provisions were required in either year.

"In calculating goodwill impairment, Fortis determines those reporting units that will have fair value estimated by an independent external consultant, as described above, and such estimated fair value is then compared to the book value of the applicable reporting units. If the fair value of the reporting unit is less than the book value, then a second measurement step is performed to determine the amount of the impairment. The amount of the impairment is determined by deducting the fair value of the reporting unit's assets and liabilities from the fair value of the reporting unit to determine the implied fair value of goodwill, and then comparing that amount to the book value of the reporting unit's goodwill. Any excess of the book value of the goodwill over the implied fair value is the impairment amount recognized.

"The primary method for estimating fair value of the reporting units is the income approach, whereby net cash flow projections for the reporting units are discounted using an enterprise value approach. Under the enterprise value approach, sustainable cash flow is determined on an after-tax basis, prior to the deduction of interest expense, and is then discounted at the weighted average cost of capital to yield the value of the enterprise. An enterprise value approach does not assess the appropriateness of the reporting unit's existing debt level. The estimated fair value of the reporting unit is then determined by subtracting the fair value of the reporting unit's interest-bearing debt from the enterprise value of the reporting unit. A secondary valuation method, the market approach, is also performed by an independent external consultant as a check on the conclusions reached under the income approach. The market approach includes comparing

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
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DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

various valuation multiples underlying the discounted cash flow analysis of the applicable reporting units to trading multiples of guideline entities and recent transactions involving guideline entities, recognizing differences in growth expectations, product mix and risks of those guideline entities with the applicable reporting units."

- a. Identify the estimated amount of Goodwill that Fortis anticipates recording related to the acquisition of UNS Energy.
- b. Provide the journal entries that Fortis would use to record the Goodwill, and indicate on which entity's books such journal entries would be utilized.
- c. Identify and provide the journal entries that would be used to record any impairment of Goodwill and indicate on which entity's books such journal entries would be utilized.
- d. Identify what "reporting unit" Fortis would use to evaluate impairment of Goodwill that Fortis anticipates recording related to the acquisition of UNS Energy.
- e. When will the estimated Goodwill related to the acquisition of UNS Energy be tested for impairment and briefly describe how this testing will be performed including what assumptions would be used, such as source of cash flow forecasts, growth assumptions, discount rates and terminal value.
- f. What future events could lead to an impairment of the estimated Goodwill related to the acquisition of UNS Energy?
- g. Did Fortis record any Goodwill related to its acquisition of any of the utilities in British Columbia, Canada, which are now identified by Fortis as FEVI, FEWI and/or FortisBC Electric?
  1. If so, identify the amounts of Goodwill that were recorded by Fortis (and identify the entity upon whose books the Goodwill was recorded).
  2. Did Fortis recognize any impairment of any Goodwill for any of the BC utilities (i.e., for FEVI, FEWI and/or FortisBC Electric) related to the authorized Return on Equity (ROE) being reduced for any of these utilities, or for any other reason since Fortis acquired them? If so, identify, quantify and explain the related Goodwill impairments. If not, explain how a Goodwill impairment was avoided for the reductions in authorized ROEs for these utilities.

**RESPONSE:**

- a. As shown in the table below, the estimate of goodwill to be added to Fortis Inc.'s consolidated balance sheet if the acquisition of UNS Energy is approved is US\$1.407 billion (C\$1.496 billion).

The goodwill amount has been estimated based on UNS Energy's consolidated net assets and common stock outstanding as at December 31, 2013. It has also been assumed that the book value of UNS Energy's consolidated net assets being acquired approximate their

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**April 4, 2014 (COMPLETE SET)**

fair value. The amount of goodwill, therefore, is subject to change based on the actual consolidated net assets of UNS Energy and common stock outstanding as at the actual closing date of the merger and the determination of fair value adjustments, if any.

<b>Goodwill Estimation <sup>(1)</sup></b> <i>(US\$ millions)</i>	
Cash purchase price of UNS Energy common stock	2,503 <sup>(2)</sup>
Estimated payout of liability (not currently recognized in UNS Energy's net assets) associated with unexercised UNS Energy stock options and accelerated vesting of restricted and performance share units (RSUs and PSUs)	35 <sup>(2)</sup>
	<u>2,538</u>
Consolidated net assets of UNS Energy to be acquired	<u>(1,131) <sup>(3) (4) (5)</sup></u>
Excess of cash purchase price over net assets to be acquired	<u><b>1,407 <sup>(5)</sup></b></u>
US\$ Exchange at December 31, 2013	1.0636
Total goodwill upon merger	C\$1,496

<sup>(1)</sup> Assuming a December 31, 2013 merger closing date

<sup>(2)</sup> Cash purchase price of UNS Energy's common stock is calculated at US\$60.25 per share multiplied by UNS Energy's total common stock outstanding as at December 31, 2013 (per page K-80 of UNS Energy's Form 10-K for the year ended December 31, 2013 filed February 25, 2014) of 41,538,343 = US\$2,502,685,166. The cash purchase price of UNS Energy's common stock and payout of the liability related to unexercised UNS Energy stock options and accelerated vesting of restricted share units ("RSUs") and performance share units ("PSUs") may change based on the actual number of common shares outstanding and the liability associated with stock options, RSUs and PSUs as at the actual closing date of the merger.

<sup>(3)</sup> Consolidated net assets of UNS Energy to be acquired as at December 31, 2013 (obtained from pages K-78 and K-79 of UNS Energy's Form 10-K for the year ended December 31, 2013 filed February 25, 2014) is calculated as follows:

Total assets	4,273
Less: Long-term debt & capital lease obligations (including current portion)	(1,846)
Less: Total current liabilities (excluding current portion of long-term debt & leases)	(327)
Less: Total deferred credits and other liabilities	(487)
Less: Accumulated deferred income tax	<u>(482)</u>
Net assets to be acquired	<u><b>1,131</b></u>

<sup>(4)</sup> Consolidated net assets of UNS Energy to be acquired may change as of the actual closing date of the merger.

<sup>(5)</sup> Assuming book value of the consolidated net assets of UNS Energy to be acquired approximates fair value. No fair value adjustments are currently expected as at the actual closing date of the merger.

b. **RUCO Fortis 2.05 Attachment A.xlsx** sets out the journal entries related to the recording of goodwill on Fortis Inc.'s books. Fortis Inc. anticipates that the goodwill will be recorded on Fortis Inc.'s consolidated balance sheet.

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FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")

UniSource Energy Services ("UES")

UNS Electric, Inc. ("UNS Electric")

UNS Energy Corporation ("UNS Energy")

UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

However, U.S. GAAP may require that goodwill also be recorded on the acquired company's books if it is a public reporting issuer. TEP is currently a public reporting issuer and may remain so after the acquisition. **RUCO Fortis 2.05 Attachment B.xlsx** sets out the journal entry that may be required on TEP's books in accordance with U.S. GAAP, assuming 80% of the estimated goodwill (i.e., US\$1.126 billion) is attributed to TEP and assuming that TEP remains a public reporting issuer following the merger. See RUCO UNS 2.06.

No matter where it is recorded, goodwill will have no effect on the customers of UNS Energy's regulated subsidiaries. See section III(5) of the Joint Notice Of Intent To Reorganize (the "Notice") wherein it states that, "UNS Energy, the Arizona Utilities and FortisUS agree that the goodwill and transaction costs of this acquisition will be excluded from the rate base, expenses, and capitalization in the determination of rates and earned returns of the Arizona Utilities and for Arizona state regulatory accounting and reporting purposes".

- c. **RUCO Fortis 2.05 Attachment C.xlsx** sets out the journal entry to record an impairment of goodwill, if applicable. Fortis anticipates that the journal entry would be recorded in the consolidated books of Fortis Inc., unless the application of U.S. GAAP requires that goodwill and any associated impairment of that goodwill have to be "pushed down" to TEP, as referred to in part b above.

Regardless of whether goodwill impairment is recorded, or where it is recorded in accordance with U.S. GAAP, it will not have any effect on the customers of UNS Energy's regulated subsidiaries. See section III(5) of the Notice wherein it states that, "UNS Energy, the Arizona Utilities and FortisUS agree that the goodwill and transaction costs of this acquisition will be excluded from the rate base, expenses, and capitalization in the determination of rates and earned returns of the Arizona Utilities and for Arizona state regulatory accounting and reporting purposes".

- d. Fortis anticipates that UNS Energy would be a single reporting unit for the annual assessment of goodwill. UNS Energy would be seen as a single reporting unit because TEP, UNS Electric and UNS Gas are essentially operated and managed as a single utility.
- e. Initially, the fair value of the goodwill associated with UNS Energy will be evaluated as part of the purchase price allocation whereby an independent external consultant estimates the fair value of assets acquired against the price paid. Subsequent to the acquisition, the goodwill associated with UNS Energy will be evaluated annually. The annual impairment testing will follow the Fortis policy which is most recently described in the Corporation's 2013 Annual Report.

Annually, Fortis performs both qualitative and quantitative assessments of goodwill for each reporting unit. For those reporting units where: (i) the assessment of quantitative and qualitative factors indicates that fair value is not 50% or more likely to be greater than carrying value; or (ii) where the excess of estimated fair value over carrying value,

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as determined by an independent external consultant as of the date of the immediately preceding impairment test, was not significant, then the fair value of the reporting unit will be estimated by an independent external consultant in the current year. At a minimum, the fair value for each Fortis reporting unit will be estimated by an independent external consultant once every three years.

In testing for goodwill impairment, the primary method for estimating the fair value of the reporting unit is the income approach, whereby the net cash flow projections for the reporting unit are discounted using an enterprise value approach. Under the enterprise value approach, sustainable cash flow is determined on an after-tax basis, prior to the deduction of interest expense, and is then discounted at the weighted average cost of capital to yield the value of the enterprise. The fair value of the reporting unit's interest-bearing debt is then subtracted from the enterprise value of the reporting unit to arrive at the reporting unit's estimated fair value.

A secondary valuation method, the market approach, is also performed by the independent external consultant as a check on the conclusions reached under the income approach. The market approach includes comparing various valuation multiples underlying the discounted cash flow analysis of the applicable reporting unit to trading multiples of guideline entities and recent transactions involving guideline entities, recognizing differences in growth expectations, product mix and the risks of those guideline entities with the applicable reporting unit.

The following key assumptions will likely be used in the initial estimation of the fair value of UNS Energy:

1. UNS Energy provided Fortis with cash flow forecasts from 2015 – 2024. Fortis extended these forecasts out through to 2034 assuming long-term growth of 2% to 3%.
  2. The terminal value of the enterprise is calculated based on a multiple of EBITDA of 8.5 to 9.5 times. These exit multiples are consistent with the results of the application of the Gordon Constant Growth formula and with market precedents.<sup>1</sup> The terminal value is not an assumption of an eventual sale of the business, but of the enterprise value of the business on a steady state basis.
  3. The discount rate used in the calculation of fair value is an after tax weighted average cost of capital (the "WACC"). The WACC which will be used in the estimate will range from 5% to 5.5%.<sup>2</sup>
- f. A significant reduction in the financial strength and prospects of the Arizona Utilities, including reduced cash flows over the long term, would likely cause impairment of

<sup>1</sup> See Definitive Proxy Statement 14A page 42 dated February 18, 2014

<sup>2</sup> Lazard valuation used a discount rate of 5.5% to 6.0%, see Definitive Proxy Statement 14A page 41 dated February 18, 2014

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**April 4, 2014 (COMPLETE SET)**

goodwill. An example of such an event would be the removal of a significant asset from rate base resulting in material unrecovered costs and lower sales revenue. This event would also most likely reduce the credit strength of the utilities and result in diminished capital access.

g. Yes.

1. Fortis recorded goodwill as follows: (i) FEI, C\$769 million; (ii) FEVI, C\$145 million; and (iii) FortisBC Electric, C\$235 million.<sup>3</sup> These entities are all public reporting issuers in Canada. Therefore, the goodwill associated with their acquisition by Fortis is recorded on their respective books, in accordance with U.S. GAAP.
2. No. Fortis has never recognized any impairment of goodwill for the noted entities, or for any other affiliate. Impairment testing was last performed as at October 1, 2013 by an external independent consultant for FEI, FEVI and FortisBC Electric. It was determined at that time that the fair value of these reporting units, based on cash flows revised to reflect the change in rates resulting from the generic cost of capital decision (i.e., the reductions in authorized ROEs for these utilities) still exceeded their book values. Consequently, there was no impairment of goodwill.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

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<sup>3</sup> FEI refers to FortisBC Energy Inc. and FEVI refers to FortisBC Energy (Vancouver Island) Inc. No goodwill was reported by FortisBC Energy (Whistler) Inc. ("FEWI").

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**Attachment A**  
**RUCO Fortis 2.05**

**JOURNAL ENTRIES - RECORDING OF GOODWILL (US\$ millions)**

Fortis records all of goodwill

Fortis non-consolidated Books	<u>Debit</u>	<u>Credit</u>
<b>JE1</b>		
Investment regarding UNS Energy	2,538	
Cash		2,538
To record purchase of UNS Energy common shares.		
<b>JE2 - Fortis Inc. Consolidating Entry</b>		
Goodwill	1,407	
Various balance sheet accounts (net investment assets & liabilities)	1,131	
Investment in UNS Energy		2,538

*To record UNS Energy on consolidated balance sheet of Fortis Inc.*

**Attachment B**  
**RUCO Fortis 2.05**

**JOURNAL ENTRIES - RECORDING OF GOODWILL (US\$ millions)**  
**TEP records 80% of goodwill**

<b>TEP Non-consolidated Books</b>	<b><u>Debit</u></b>	<b><u>Credit</u></b>
<b>JE1</b>		
Goodwill	1,126	
Contributed capital		1,126
<i>To record purchase of UNS Energy common shares by Fortis and the pushdown of goodwill attributable to TEP if required by U.S. GAAP.</i>		

**Attachment C**  
**RUCO Fortis 2.05**

**JOURNAL ENTRY - RECORDING OF GOODWILL IMPAIRMENT**

<b>Fortis (and TEP, if required by U.S. GAAP)</b>	<b><u>Debit</u></b>	<b><u>Credit</u></b>
Loss on Impairment of Goodwill (Income Statement)	XXX	
Goodwill		XXX
To record loss on impairment of goodwill		
(TEP to record 80% of goodwill impairment if required by U.S. GAAP.)		

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**January 28, 2014**

**UDR 1.37**

Please confirm that TEP, UNS Gas, and UNS Electric will not seek rate recovery of any premium paid by Fortis Inc. for UNS Energy common stock or any transaction cost associated with the acquisition.

**RESPONSE:**

Pursuant to stipulated condition No. 5 included in the Joint Notice of Intent to Reorganize, TEP, UNS Gas and UNS Electric will not seek rate recovery of any premium to be paid by Fortis for UNS Energy common stock or any transaction cost associated with the acquisition.

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
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DOCKET NO. E-04230A-14-0011, et al.**

**February 27, 2014**

**RUCO Fortis 1.04**

Page 2 of the Joint Notice Of Intent To Reorganize states that UNS Energy and Fortis have agreed to conditions for approval that ensure continuing high levels of customer service, community support and involvement, and local management and corporate governance. Page 5 of the Joint Notice states that: "The State of New York Public Service Commission ("NYPSC") recently concluded that it was in the public interest for Fortis to acquire Central Hudson Gas & Electric Corporation, a gas and electric utility serving approximately 376,000 customers in New York State." Referring to NYPSC Case No. 12-M-0192 - Joint Petition of Fortis Inc. et al. and CH Energy Group, Inc. et al. for Approval of the Acquisition of CH Energy Group, Inc. by Fortis Inc. and Related Transactions, NYPSC Order Authorizing Acquisition Subject To Conditions (Issued and Effective June 26, 2013):

- a. Identify each condition that was applied to Fortis' acquisition of CH Energy Group.
- b. For each condition identified in response to part a, state whether the same or similar condition has been proposed for Fortis' proposed acquisition of UNS Energy Corporation.
- c. For each condition identified in response to part a, state whether Fortis would proceed with the proposed acquisition if the same or similar condition is imposed with respect to Fortis' proposed acquisition of UNS Energy Corporation.

**RESPONSE:**

- a. **RUCO Fortis 1.04 Attachment A.pdf, Bates Nos. 001811-001828**, includes the terms and conditions (the "CH Conditions") applied to Fortis and Central Hudson with respect to the Fortis acquisition of CH Energy Group (the "CH Acquisition").

The majority of the CH Conditions proposed by Fortis and CH Energy in the petition for approval of the CH Acquisition filed with the NYPSC in April 2013 were intended to:

- (i) address and resolve concerns which arose in prior merger cases before the NYPSC, most notably the conditions applied by the NYPSC in the Iberdrola S.A. acquisition of Energy East Corporation in 2008 (the "Energy East Acquisition"), in a manner consistent with the NYPSC's disposition of these precedent setting cases;
- (ii) deal with specific circumstances unique to the CH Acquisition and the customers of Central Hudson; and,
- (iii) be consistent with the standalone operating philosophy of Fortis.

Certain of the CH Conditions were specifically intended to address the "net positive benefits" test that is applied to the acquisition of utilities in New York pursuant to New York's Public Service Law ("PSL") Section 70. In addition, some of the CH Conditions were the product of settlement negotiations that culminated in a joint settlement agreement which was filed with the NYPSC in January 2013 (the "CH Settlement"), and enhancements offered by Fortis prior to approval of the transaction based on further discussions with other interested parties. Only CH Condition A.5.g, which deals with

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indemnification for tax obligations, was added by the NYPSC in conjunction with its final approval of the CH Acquisition in June 2013.

- b. The conditions agreed to by Fortis and UNS Energy (the "UNS Conditions") in the proposed acquisition (the "UNS Acquisition") are outlined in Part III of the Joint Notice of Intent to Reorganize dated January 10, 2014 and in Part VI (and Exhibit BVP-7) of the Direct Testimony of Barry V. Perry dated January 24, 2014.

The UNS Conditions address: quality of service; capital requirements; treatment of goodwill, acquisition costs and synergy savings; credit quality and other restrictions; legal separateness; financial transparency and reporting conditions; affiliate transactions; corporate governance and operational provisions; and low income assistance. These agreed-upon conditions have been tailored to meet the standard for Commission approval of acquisitions based on Arizona's Public Utility Holding Companies and Affiliated Interests rules.

Many of the UNS Conditions are the same or similar to the CH Conditions, as follows:

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***Quality of Service [Exhibit BVP-7 ¶¶ 1 and 2]***

UNS Energy, FortisUS and Fortis acknowledge and agree to support the Arizona Utilities in maintaining a high level of customer service and providing safe, reliable service to their customers. In addition, the Arizona Utilities agree to maintain, and if necessary improve, their current quality of service so that the number of service complaints does not increase, that the response time to service complaints does not increase and that service interruptions do not increase as a result of the transaction.

These conditions are similar in nature and intent to the conditions contained in Sections B.1 through B.6 of the CH Conditions, bearing in mind that the CH Conditions are specific to their operations and issues brought forward by parties to the CH Settlement.

***Treatment of Goodwill, Acquisition Costs and Synergy Savings [Exhibit BVP-7 ¶¶ 5-8]***

These conditions are similar in nature and intent to the conditions contained in Sections A.1 and A.10 of the CH Conditions.

The filing requirement specified in Section A.1.b of the CH Conditions was requested by staff of the NYPSC during settlement negotiations. Fortis does not believe it should impose unnecessary administrative burden on the Arizona Commission and has, therefore, not included this requirement in the UNS Conditions.

Sections A.10.b and A.10.c of the CH Conditions were intended to address the NYPSC's "net positive benefits" test which is specific to New York and which has not been applied to the acquisition of utilities in Arizona.

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***Credit Quality and Other Restrictions [Exhibit BVP-7 ¶¶ 9-15]***

These conditions are similar in nature and intent to the conditions contained in Sections A.2 and A.3 of the CH Conditions.

The filing requirement specified in Section A.2.a of the CH Conditions was requested by staff of the NYPSC during settlement negotiations. Fortis does not believe it should impose unnecessary administrative burden on the Arizona Commission and has, therefore, not included this filing requirement in the UNS Conditions.

Sections A.2.d, A.2.e, A.2.i and A.3.a of the CH Conditions are also specific to Central Hudson or were included at the specific request of NYPSC staff during settlement negotiations.

***Legal Separateness [Exhibit BVP-7 ¶ 16]***

This condition is intended to provide assurance that the Arizona Utilities will amend their respective organizational documents to provide for and ensure legal separateness from UNS Energy and Fortis. Central Hudson provided similar assurances in Section A.4.a of the CH Conditions. This particular CH Condition was deemed necessary by the NYPSC due to the lower credit ratings of Fortis compared to those of Central Hudson. However, the credit ratings of Fortis are higher than those of UNS Energy and the Arizona Utilities. In that regard, the Arizona Utilities, and their customers, thereby stand to benefit from being affiliated with Fortis. As stated in the Direct Testimony of Kevin P. Larson, "S&P and Fitch Ratings, Inc. ("Fitch") indicated that TEP's ratings could be raised by one notch if the acquisition is approved, while Moody's acknowledged the benefit of joining an established utility company of Fortis' size and scope." *The benefits of potential credit rating upgrades for the Arizona Utilities could be hampered if a condition similar to that imposed by the NYPSC were applied to the UNS Acquisition.* In addition, the inclusion of such a condition in this case would require waivers or amendments to the UNS Energy/Arizona Utilities credit facilities, which may or may not be obtainable without cost.

Section A.4.b of the CH Conditions was added at the request of parties to the CH Settlement. Fortis believes that this condition should apply in any event based on the fact that the Arizona Utilities will be managed, governed, financed and operated on a standalone basis. It has, therefore, not been included as a specific UNS Condition.

***Financial Transparency and Reporting Conditions [Exhibit BVP-7 ¶¶ 17-19]***

These conditions are similar in nature and intent to those contained in Sections A.5.a, A.5.e and A.5.f of the CH Conditions.

Sections A.5.b and A.5.h of the CH Conditions were added at the specific request of NYPSC staff during settlement negotiations. Fortis believes that these conditions are redundant based on existing business, statutory and regulatory requirements. Therefore, they have not been specifically included in the UNS Conditions.

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Sections A.5.c, and independent auditor attestation of internal controls over financial reporting referred to in Section A.5.d, of the CH Conditions was also added at the specific request of NYPSC staff. However, SOX compliance by UNS Energy will not be required once it is no longer a public company. Additionally, TEP will have a choice as to whether or not it will remain a public company subject to SEC reporting requirements and SOX compliance. Fortis believes that its own internal controls implementation, assessment and certification process is essentially equivalent to that required by SOX and that eliminating the requirement to comply with SOX 302 – 404, specifically the requirement for external auditor attestation of internal controls, provides opportunity for cost savings that can, and should, be passed on to customers.<sup>1</sup>

***Affiliate Transactions [Exhibit BVP-7 ¶ 20]***

This condition is similar in nature and intent to those contained in Section A.6 of the CH Conditions.

***Corporate Governance and Operational Provisions [Exhibit BVP-7 ¶¶ 21-23]***

These conditions are similar in nature and intent to those contained in Section A.8 of the CH Conditions.

Section A.8.c was added at the specific request of NYPSC staff during settlement negotiations.

***Low income assistance [Exhibit BVP-7 ¶ 24]***

These conditions are similar in nature and intent to those contained in Section C.1 of the CH Conditions, bearing in mind that the CH Conditions are specific to their operations and issues brought forward by parties to the CH Settlement.

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The remaining CH Conditions, as contained in Sections A.7, A.9, C.2 and D.1 through D.3, are specific to Central Hudson and New York, and therefore have not been included in the UNS Conditions.

The commitment by Fortis to provide the necessary equity capital when required, and to inject \$200 million in new equity upon closing [Exhibit BVP-7 ¶¶ 3-4], have been included in the UNS Conditions to reflect the specific circumstances relevant to the UNS Acquisition, the needs of UNS Energy and the regulatory framework that exists in Arizona. These conditions were not included in the CH Conditions.

The UNS Conditions and CH Conditions referred to above recognize the inherent differences that exist between UNS Energy and Central Hudson, their respective circumstances, needs, customer interests and regulatory jurisdictions, including inherent

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<sup>1</sup> Securities laws in Canada include SOX-equivalent legislation, with one exception. Canadian securities laws do not require an independent audit opinion on internal controls, as is required by U.S. public companies under SOX.

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differences in application of the public interest standard in Arizona as compared to New York. The UNS Conditions should be assessed collectively, together with other benefits to be derived by customers of the Arizona Utilities, in determining whether the public interest standard, as applied in Arizona, has been met. The UNS Acquisition will provide overall benefits to customers and is in the public interest.

- c. Section 5.5 (b) of the Agreement and Plan of Merger between Fortis and UNS Energy<sup>2</sup> states that, "In the application filed with the ACC for the ACC Approval, Merger Sub and the Company shall agree to include specific commitments and agreements in such application to implement the principles set forth in Section 5.5(b) of the Company Disclosure Letter." Section 5.5(b) of the Company Disclosure Letter is contained in **RUCO Fortis 1.04 Attachment B.pdf, Bates Nos. 001800-001804**. Should additional conditions be imposed, Fortis will then have to determine whether it is willing to proceed with the acquisition of UNS Energy. No determination can be made until a specific condition is imposed.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

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<sup>2</sup> A copy of which has been provided in Exhibit BVP-5 to the Direct Testimony of Barry V. Perry

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**Terms & Conditions**  
**New York Public Service Commission ("Commission") Approval of the Acquisition of CH**  
**Energy Group, Inc. ("CHEG") by Fortis Inc. ("Fortis")<sup>1</sup>**

**A. Corporate Structure and Financial Protections**

**1. Goodwill and Acquisition Cost Conditions**

a) The Goodwill and transaction costs of this acquisition will be excluded from the rate base, expenses, and capitalization in the determination of rates and earned returns of Central Hudson Gas & Electric Corporation ("Central Hudson") for New York State regulatory accounting and reporting purposes.

b) If, at any time after the closing of this acquisition, as a result of any impairment analysis by Fortis, FortisUS<sup>2</sup>, CHEG or Central Hudson, either Fortis or FortisUS makes a book entry reflecting impairment of the Goodwill from this acquisition, Central Hudson must submit the impairment analysis to the Commission within five business days after the entry has been made.

c) To the extent permissible under U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), no goodwill or transaction costs associated with this acquisition will be reflected on the books maintained by Central Hudson after the closing of the acquisition of CHEG by FortisUS and Fortis. Should changes in U.S. GAAP require that the goodwill associated with the acquisition be "pushed down" and therefore reflected in the accounts of Central Hudson, the goodwill will not be reflected in the regulated accounts of Central Hudson for purposes of determining rate base, setting rates, establishing capital structure or other regulatory accounting and reporting purposes.

d) Central Hudson will provide a final schedule of the external costs to achieve the merger following consummation of the transaction as a demonstration that there will be no recovery requested in Central Hudson rates, or recognition in the determination of rate base of any legal and financial advisory fees, or other external costs associated with Fortis' acquisition of CHEG, and indirectly, Central Hudson.

**2. Credit Quality and Dividend Restriction Conditions**

a) After the closing of this transaction, copies of all presentations made to credit rating agencies by Central Hudson, Fortis or any Fortis affiliate in the line between Central Hudson and Fortis that present or discuss the finances and credit of Central Hudson or CHEG, will be provided to Staff within ten business days of the presentation on a continuing basis. These presentations will be subject to the confidentiality and privilege provisions of sections VLB 32 and 33 of the Restructuring Settlement Agreement ("RSA") approved by the Commission in Case 96-E-0909.

b) To the extent not already in place, Fortis and Central Hudson must register with at least two major nationally and internationally recognized bond rating agencies, such as Dominion Bond Rating Services ("DBRS"), Fitch Ratings ("Fitch"), Moody's Investor Services ("Moody's") and

<sup>1</sup> "Signatories" jointly refers to all parties to the joint settlement agreement dated January 25, 2013. "Petitioners" jointly refers to Fortis, CHEG and Central Hudson Gas & Electric Corporation.

<sup>2</sup> FortisUS Inc.

Standard & Poor's ("S&P"). Consistent with section VI.B 20 of the RSA, Central Hudson will continue to maintain separate debt instruments and its own corporate and debt credit ratings with at least two of these nationally recognized credit rating agencies. Neither Fortis nor Central Hudson will enter into any credit or debt instrument containing cross default provisions that would affect Central Hudson.

c) Fortis and Central Hudson will continue to support the objective of maintaining an "A" credit rating for Central Hudson, unless and until the Commission modifies its financial integrity policies. In so doing, Fortis and Central Hudson will maintain the equity capitalization ratio of Central Hudson at the level used by the Commission in establishing Central Hudson's rates as follows. At each month end, Central Hudson and Fortis agree to maintain a minimum common equity ratio ("MER") (measured using a trailing 13-month average) in relation to the equity ratio used to set rates. The MER is defined as no less than 200 basis points below the equity ratio used to set rates. In the event that the MER is not met, no dividends are payable until such time the MER is restored.

d) In the event the Commission establishes rates for Central Hudson on a basis that does not recognize Central Hudson's actual equity capitalization, or deems or imputes for ratemaking purposes an equity capitalization below Central Hudson's actual equity capitalization, Central Hudson shall be free to dividend its excess equity capitalization to match that recognized or deemed by the Commission in establishing Central Hudson's rates.

e) If, as a direct result of a downgrade of Fortis Inc.'s debt within three years following the closing of this transaction, Central Hudson is downgraded to either S&P's or Fitch's BBB category (BBB+ or lower), or the equivalent for Moody's (Baa or lower) or DBRS's (BBB(high) or lower), and Central Hudson incurs increased costs of debt, the incremental cost of debt incurred by Central Hudson in comparison to the cost of debt which would otherwise have been incurred by Central Hudson under its pre-downgrade credit rating will not be reflected in Central Hudson's cost of capital or the determination of Central Hudson's rates in subsequent rate cases. If such a downgrade occurs in the time discussed and debt is issued, then in subsequent rate cases Mergent Bond Record data (or the equivalent, if Mergent data is not available) for the relevant month(s) of issue will be used to quantify the adjustment needed to avoid reflecting the higher interest rate expense. For each one-notch downgrade to Central Hudson, one-third of the difference between A and Baa Public Utility Bond yield averages will be used to adjust the interest rate allowed in rate cases. The differential will only apply for each credit rating agency which downgrades Central Hudson's debt due to a Fortis downgrade. For instance, if Central Hudson is rated by two credit rating agencies and only one downgrades them due to a Fortis downgrade, then only 50% of the one-notch yield difference per Mergent Bond Record data will be used to calculate the interest rate adjustment in subsequent rate cases.

f) Central Hudson will continue to comply with any and all sections of the RSA with respect to restrictions on the payment of common dividends related to credit ratings.

g) Central Hudson will not lend to, guarantee or financially support Fortis or any of its affiliates, or any subsidiary or other joint venture of Central Hudson, except as is consistent with section VI.B 23 of the RSA or permitted by the Money Pooling Conditions referred to below.

Furthermore, Central Hudson will not engage in, provide financial support to or guarantee any non-regulated businesses, except as authorized in the RSA or by Commission order.

h) Central Hudson shall maintain banking, committed credit facilities and cash management arrangements which are separate from other affiliates.

i) In addition to the special class of preferred stock referred to in item 4, below, Central Hudson's financing authorization in Case 12-M-0172, Order Authorizing Issuance of Securities, issued and effective September 14, 2012 ("Financing Order") is amended to authorize Central Hudson to use private financing as an alternative to public debt offerings. This authorization supersedes Ordering Clause 5 in the Financing Order. Private financings are subject to the conditions and requirements described in the other Ordering Clauses in the Financing Order and, Central Hudson's proposal to address Ordering Clause 6 in the Financing Order, as was filed with the Commission on November 9, 2012, is accepted and approved by the Commission's adoption of this Joint Proposal.

### **3. Money Pooling Conditions**

a) Central Hudson may participate in a money pool only if all other participants, with the exception of Fortis and FortisUS, are regulated utilities operating within the United States, in which case Central Hudson may participate as either a borrower or a lender. Fortis and FortisUS may participate only as lenders in money pools involving Central Hudson. Central Hudson may not participate in any money pool in which any participant directly or indirectly loans or transfers funds to Fortis or FortisUS.

b) Neither Fortis nor FortisUS, nor any of their affiliates may, at closing of the approved acquisition of Central Hudson, have any cross default provision that affects Central Hudson in any manner. Neither Fortis nor FortisUS, nor any of their affiliates may enter into any cross default provision following the closing that affects Central Hudson in any manner. Notwithstanding the foregoing, to the extent that any cross default provision that might affect Central Hudson already exists, Fortis and FortisUS must use their best efforts to eliminate that cross default provision within six months after closing. If any cross default provision remains in effect at the end of that period, Fortis and FortisUS must obtain indemnification from an investment grade entity, at a cost not borne by Central Hudson's ratepayers, which fully protects Central Hudson from the effects of any cross default provision.

### **4. Special Class of Preferred Stock Conditions**

a) Central Hudson must modify its corporate by-laws as necessary to establish a voting right in order to prevent a bankruptcy, liquidation, receivership, or similar proceedings ("bankruptcy") of Central Hudson from being caused by a bankruptcy of Fortis, FortisUS, or any other affiliate. The Commission's approval of this Joint Proposal will represent all Commission authorization necessary for Central Hudson to establish a class of preferred stock having one share (the "golden share"), subordinate to any existing preferred stock, and to issue that share of stock to a party who shall protect the interests of New York and be independent of the parent company and its subsidiaries. Such share of stock shall have voting rights only with respect to Central Hudson's right to commence any voluntary bankruptcy without the consent of the holder of that share of stock. Central Hudson shall notify the Commission of the identity and qualifications of

the party to whom the share is issued and the Commission may, to the extent that such party is not reasonably qualified to hold such share in the Commission's opinion, require that the share be reissued to a different party within three months of receipt of such notification. If Central Hudson has failed to propose a shareholder that is approved by the Commission within six months after the closing of the acquisition, the Commission will appoint a shareholder of its own selection. In the event that Central Hudson is unable to meet this condition despite good faith efforts to do so, it must petition for relief from this condition, explaining why the condition is impossible to meet and how it proposes to meet an underlying requirement that a bankruptcy involving Fortis, FortisUS, or any other affiliate does not result in its voluntary inclusion in such a bankruptcy.

b) In any rate proceeding in which use of Central Hudson's capital structure is requested, Central Hudson will submit the most current written evaluations from at least two rating agencies addressing Central Hudson's credit profile. These credit reports shall be relied upon to the extent that they provide written evidence that supports the evaluation of Central Hudson and the treatment of Central Hudson's capital structure by the Commission primarily as a separate company, without material adjustments to the rating based on risks related to the capital structure and ratings of its ultimate parent. This evidence, together with the golden share would provide sufficient proof that the use of Central Hudson's capital structure should be used for rate making purposes. In the event written evaluations from at least two rating agencies do not provide such evidence or are not available, Central Hudson shall have the opportunity to meet its burden of proof through other means. Central Hudson's capital structure will continue to be reviewed in relation to the level of risk of Central Hudson at that time.

#### **5. Financial Transparency and Reporting Conditions**

a) Central Hudson must continue to use the standards of Generally Accepted Accounting Principles applicable to publicly-traded entities ("Public GAAP," "U.S. GAAP," or simply "GAAP") for its financial accounting and financial reports. Central Hudson will, for purposes of its financial accounting and financial reporting, continue to use the generally accepted accounting principles which include, but are not limited to the determinations by the Financial Accounting Standards Board ("FASB"), or any successor entity, for U.S. publicly accountable enterprises ("U.S. GAAP" or simply "GAAP"). Any future changes in U.S. GAAP, including any decision to replace U.S. GAAP with International Financial Reporting Standards ("IFRS"), will be applied by Central Hudson. In the event of future changes to accounting standards, recovery by Central Hudson for the incremental costs incurred in making such changes will be addressed in a future rate proceeding.

b) Central Hudson must continue to satisfy all Commission reporting requirements that currently apply to it; provided however, that nothing in this provision is intended to preclude Central Hudson from requesting relief from any such reporting provision and, further, that nothing herein is intended to require Central Hudson to continue to make reports in the future that utilities have been generally or generically excused by the Commission from making.

c) After the closing of this acquisition, Central Hudson shall continue to comply with the provisions of sections 302 through 404 of the Sarbanes-Oxley Act ("SOX") as if Central Hudson were still bound directly by the provisions of SOX, with the understanding that no filings with

the Securities and Exchange Commission will be required. Specifically, Central Hudson's periodic statutory financial reports must continue to include certifications provided by its officers concerning compliance with SOX requirements, including certifications on internal controls, as if still bound by the provisions of SOX.

d) Central Hudson shall remain subject to annual attestation audits by independent auditors with respect to its financial statements and internal controls over financial reporting.

e) Subject to the confidentiality and privilege provisions of sections VI.B 32 and 33 of the RSA, Fortis and Central Hudson will provide Staff access pursuant to section VI.B 30 of the RSA to the books and records and Standards Pertaining To Transactions, Conflicts Of Interest, Cost Allocations And Sharing Of Information Between Central Hudson Gas And Electric Corporation And Affiliates ("Standards"), including, but not limited to, tax returns, of Fortis and FortisUS to the extent necessary to determine whether the rates and charges of Central Hudson are just and reasonable and provide Staff the opportunity to ensure that costs are allocated equitably among affiliates in accordance with the RSA, Standards and Central Hudson code of conduct and that intercompany transactions involving Central Hudson are priced reasonably in accordance with the RSA, Standards and Central Hudson code of conduct. Subject to the confidentiality and privilege provisions of sections VI.B 32 and 33 of the RSA, that access must include, but not be limited to, all information supporting the underlying costs and the basis for any factor that determines the allocation of those costs.

f) Commencing for the year in which the closing takes place, Central Hudson must file annually with the Commission Fortis financial statements, including balance sheets, income statements, and cash flow statements for Fortis, Inc. and its major regulated and unregulated energy company subsidiaries in the United States. U.S. business entities with annual revenues less than ten percent of total Fortis revenues may be aggregated, provided that each entity included is fully identified. Aggregated U.S. business entities shall be identified as either regulated or unregulated. To satisfy this filing requirement, Fortis Inc.'s U.S. GAAP Canadian dollar denominated quarterly and annual Financial Reports, including Management Discussion and Analysis, which have been filed publically with Canadian securities regulators, will be filed by Central Hudson with the Commission. Additionally, Central Hudson will provide to the Commission, to the extent available from a recognized financial reporting information service such as SNL Financial or Bloomberg, Fortis Inc.'s "as reported" quarterly and annual Balance Sheet, Income Statement and Statement of Cash Flows in U.S. dollars with the underlying currency translation assumptions.

g) Fortis will indemnify Central Hudson for any tax obligations Central Hudson incurs as result of Central Hudson's United States federal and New York State income tax returns being filed as part of the consolidated tax returns of FortisUS and that it would not have occurred if Central Hudson's tax returns were filed on a stand-alone basis. Fortis and Central Hudson are required to enter into an *Income Tax Preparation and Sharing Agreement* that will formalize the income tax reporting and preparation relationship, protect Central Hudson's customers, and allocate tax benefits and obligations among the companies participating in the consolidated FortisUS income tax returns.

h) All information required by the financial transparency and reporting requirements in subparagraphs (a) through (f) above must be provided in English and in U.S. dollars, with the exception of Financial Reports and Management Discussion and Analysis referred to in subparagraph (f), and books and records and Canadian tax returns that statutorily require Canadian dollar reporting. In such cases, foreign exchange for U.S. dollar translation will be provided as described in subparagraphs (a) through (f) above and, shall be publicly available subject to the confidentiality and privilege provisions of sections VI.B 32 and 33 of the RSA.

#### **6. Affiliate Transactions, Cost Allocations, and Code of Conduct**

a) Fortis shall be subject to the rules, practices, and procedures in the RSA, Standards, and code of conduct governing relations among CHEG and Central Hudson in the same manner as they apply to CHEG.

b) Central Hudson will not enter into transactions with affiliates that are not in compliance with the RSA guidelines regarding affiliate transactions, including the updated Standards set forth in Attachment I. Central Hudson will also not enter into transactions with affiliates on terms less favorable to Central Hudson than specified in the RSA, including the updated Standards.

c) Central Hudson shall provide 180 days notice to the Commission prior to the commencement of any planned material (i.e., individually or collectively exceeding greater than 5% of Central Hudson net income on an after tax basis) shared services initiatives, and prior to establishment of a services organization that would provide material (i.e., individually or collectively exceeding greater than 5% of Central Hudson net income on an after tax basis) services to Central Hudson. Further, any such noticed shared service initiative would require Commission approval.

d) At or prior to the time of Central Hudson's next base rate filing it will consolidate the RSA, Standards and codes of conduct into one comprehensive document and file the consolidated document with the Commission. The intention of this requirement is to organize the provisions into an integrated document without altering the effect and content of the provisions.

#### **7. Follow-On Merger Savings**

a) In the event that Fortis completes any additional mergers or acquisitions within the United States before the Commission adopts an order approving new rates for Central Hudson, Fortis must share the follow-on merger savings that are reasonably applicable to Central Hudson and its customers between shareholders and ratepayers, on a 50/50 basis, to the extent the portions of such savings realized by Fortis are material (i.e., 5 percent or more of Central Hudson net income on an after-tax basis). Central Hudson must submit, within 90 days of the follow-on merger closing, a comprehensive and detailed proposal to share the follow-on merger savings, to begin on the closing date of the follow-on merger. In addition, the proposal must include an allocation method for sharing the synergy savings and efficiency gains among corporate entities that addresses the time period from the receipt of the synergy savings by Central Hudson until the Commission approves new rates. The ratepayer share shall be set aside in a deferral account for future Commission disposition.

## **8. Corporate Governance and Operational Provisions**

a) No later than one year after the closing of Fortis's acquisition of CHEG, Fortis shall appoint a board of directors for Central Hudson, the majority of whom will be independent (as defined in the Standards, see Attachment I), with the majority of such independent directors being resident in the State of New York, with emphasis on selecting candidates who reside, conduct business or work within the Central Hudson service territory. At least two independent director of Central Hudson shall be a resident of the service territory. Except with respect to the initial appointment of the board of directors for Central Hudson within one year following the closing, nothing in this Joint Proposal is intended to restrict the rights of Fortis to take any action before the Commission, or otherwise, regarding the appointment of directors meeting the above residency criteria at any time, as it sees fit.

b) Subject to the right of Central Hudson to petition the Commission for approval to relocate its corporate headquarters outside of Central Hudson's service territory, the corporate headquarters of Central Hudson shall remain within Central Hudson's service territory. Complete books and records of Central Hudson shall be maintained at Central Hudson's corporate headquarters.

c) At least 50% of Central Hudson's officers shall reside within Central Hudson's service territory.

d) Central Hudson shall be governed, managed and operated in the fashion described in Petitioners' testimony. Specifically, the Signatories agree that:

i) The board of directors of Central Hudson will be responsible for management oversight generally, including the approval of annual capital and operating budgets; establishment of dividend policy; and determination of debt and equity requirements. The Central Hudson board of directors will have an audit committee, the majority of whom will also be independent. The responsibility of this committee will include the oversight of the ongoing financial integrity and effectiveness of internal controls of Central Hudson.

ii) Central Hudson's local management will continue to make decisions regarding staffing levels and hiring practices; will continue to negotiate future collective bargaining agreements; will continue to be the direct contact and decision making authority in regulatory matters; and, will continue to represent Central Hudson in all future regulatory matters.

iii) To provide continuity in the management and staffing of Central Hudson, and ensure that the necessary human resources are maintained to continue the delivery of safe, reliable service to customers, the current employees of Central Hudson (union and management) will be retained for a period of four years following the closing under their respective current conditions of employment. Central Hudson reserves the right to take disciplinary and any other actions it determines necessary or appropriate within its existing labor agreement and employee relations practices. Central Hudson also agrees to maintain for two years after the closing the level of operating employees, as defined in the Standards, that is recognized in rates and to file a report with the Secretary of the Commission within 30 days after the first two anniversary dates of the merger's closing



comparing the level of union and management employees on the anniversary to date to the levels on the date upon which the merger closed.

iv) To ensure the continued active corporate and charitable presence of Central Hudson in its service territory, Central Hudson shall maintain its community involvement at not less than current (2011) levels for ten years after the closing of the acquisition (2013 through 2023).

## **9. Rate Freeze Provisions**

The Commission's Order Establishing Rate Plan, issued June 18, 2010, in Cases 09-E-0588 and 09-G-0589, set forth electric and gas rate plans for Central Hudson for the period July 1, 2010 through June 30, 2013. The July 1, 2013 rate reductions for S.C. 11 gas customers (see Section IX, Part B, and Appendix M, Sheet 4 of 5 of the current rate plan) will go into effect as provided in the current rate plan. In the period between July 1, 2013 and June 30, 2015 (Rate Freeze Period), the provisions of the current rate plan applicable to "rate year 3", except as modified in this Joint Proposal, are continued.

### *a) Earnings Sharing and Calculations of Earned Rates of Return*

The Earnings Sharing Provision in Section VI.D of the current Commission-approved rate plan will be modified as of July 1, 2013, to read:

Actual regulatory earnings in excess of 10.00% and up to 10.50% will be shared equally between ratepayers and shareholders. Actual regulatory earnings in excess of 10.50% will be shared 90/10 (ratepayer/shareholder). These earnings sharing percentages shall be maintained until the effective date of the succeeding Commission rate order.

The Company will defer for the future benefit of ratepayers fifty percent of its share of any actual earnings in excess of 10.50% to reduce the deferred debit under-collections of MGP Site Investigation & Remediation Costs, interest costs on variable rate, interest costs on new issuances of long term debt, property tax, and stray voltage expense; provided, however, that such reduction in deferred debit deferrals will be further limited so as not to cause the resulting actual earnings to decrease below a 10.50% return on equity.

In calculating earned rates of return for regulatory purposes, the \$35 million of combined write-offs of deferred regulatory assets and future rate mitigation funds, and the one-time funding of \$5 million for economic development and low income purposes referred to in this Joint Proposal shall be included and not "normalized out" for purposes of determining actual expenses for the rate year in which those benefits are booked by Central Hudson.

### *b) Distribution and Transmission Right-of-Way Tree Trimming and SIR Costs*

At the end of Rate Freeze Period, the actual total expenditures for distribution ROW tree trimming will be compared to \$11.397 million and any under-spending will be deferred as of the end of Rate Freeze Period. Carrying charges at the Pre-Tax Rate of Return ("PTROR") will be applied by the Company to the amount deferred from the end of Rate Freeze Period until the effective date of the succeeding Commission rate order.

At the end of Rate Freeze Period, the actual total expenditures for transmission ROW tree trimming will be compared to \$1.711 million and any under-spending will be deferred as of the end of Rate Freeze Period. Carrying charges at the PTROR will be applied by the Company to the amount deferred from the end of Rate Freeze Period until the effective date of the succeeding Commission rate order. In addition, the deferral for Manufactured Gas Plant ("MGP") Site Investigation and Remediation ("SIR") Costs authorized in Paragraph V.A.1 of the current rate plan will be modified as of July 1, 2013 to apply to all Environmental SIR costs incurred by Central Hudson during the period from July 1, 2013 to June 30, 2014. This modification does not limit Staff or the Commission's authority to review the prudence of any SIR costs.

*c) Stray Voltage Testing*

Actual Stray Voltage Testing expenditures, excluding mitigation costs, will be compared to \$2.023 million for the twelve months ending June 30, 2014. Any under-spending as of June 30, 2014, exclusive of expenditures for actual mitigation costs, will be deferred for future return to customers with carrying charges at the PTROR.

Actual mitigation costs in the twelve months ending June 30, 2014 will be compared to \$350,000. The differences between \$350,000 and actual mitigation expenditures will be deferred for future recovery by the Company, or return to customers, with carrying charges.

*d) Next Rate Case Filing*

Central Hudson may file new rate case applications at any time; however, the Fortis and Central Hudson agree to make such filing no earlier than the date that would be permitted for filing for rates to become effective on or after July 1, 2015. In its next rate case filing, Central Hudson shall provide, in a format similar to that provided in rebuttal testimony, an updated comparison between the debt ratings of Central Hudson and the regulated affiliates of Fortis based upon the latest rating agencies' analyses available at that time.

**10. Economic Benefits, Including Synergies and Positive Benefit Adjustments**

Fortis and Central Hudson have agreed to provide quantified economic benefits comprised of the following synergy and positive benefit adjustments: (i) synergy savings which are guaranteed for a period of 5 years and which will provide for future rate mitigation of \$9.25 million over the 5 years; (ii) a total of \$35 million of combined write-offs of deferred regulatory assets and future rate mitigation funds; and, (iii) one-time funding of \$5 million for a Community Benefit Fund for economic development and low income purposes.

*a) Synergy Savings/Guaranteed Rate Reductions*

The Signatories have agreed that the transaction will produce synergy savings/guaranteed future rate mitigation totaling \$9.25 million (\$1.85 million/year for 5 years). Petitioners have agreed to guarantee these cost savings for a period of five years, and will begin accruing these guaranteed cost savings in the month following closing. The Signatories recognize that this accrual will provide rate mitigation for the benefit of customers that will be available at the start of the first rate year in the next rate case filed by Central Hudson. The Signatories anticipate that the forecast effect of the synergy cost savings will also be reflected in rates in Central Hudson's next rate case.

*b) Deferred Storm Restoration Cost Write-offs and Future Rate Mitigation*

A total of \$35 million will be provided to Central Hudson by Fortis upon the closing of the transaction and will be recorded as a regulatory liability to be applied to write off regulatory assets on the books of Central Hudson due to storm restoration costs and to provide balance sheet offsets and rate mitigation in Central Hudson's next rate filing.

*i) Storm Restoration Cost Write-offs*

Central Hudson currently has two storm restoration cost deferral petitions pending before the Commission in Cases 11-E-0651 (\$11.0 million exclusive of carrying charges) and 12-M-0204 (\$1.6 million exclusive of carrying charges) , for a total of \$12.6 million exclusive of carrying charges. Additionally, Central Hudson has estimated that the incremental storm restoration costs above the current rate allowance resulting from Super-storm Sandy will be approximately \$10 million. The Signatories agree that Central Hudson shall file a formal Super-storm Sandy deferral petition as soon as reasonably practicable.

The Signatories agree to utilize a placeholder total for these three events of \$22 million. The Signatories agree that \$22 million will be written off promptly after the closing against the \$35 million regulatory liability being funded by Fortis, subject to true-up for subsequent Commission determinations concerning the storm restoration costs of the three storms. The Signatories agree that the three deferral requests will be reviewed by Staff consistent with the principles and practices in the recent Central Hudson storm restoration deferral petitions involving Twin Peaks (February 2010) in Case 10-M-0473 and the December 2008 ice storm in Case 09-M-0004.

*ii) Disposition of the Remaining Balance*

The difference between the \$35 million being provided by Fortis and the \$22 million in placeholder storm restoration cost write-offs is currently estimated as a \$13 million placeholder. The Signatories agree that this \$13 million difference will be reserved as a regulatory liability with carrying charges at the pre-tax rate of return rate. At the time of the final, trued-up storm restoration cost determination by the Commission, the reserve and associated carrying charges will be adjusted up or down to conform to the Commission's determination. The final amount will be reserved for additional future balance sheet write-offs or other rate moderation purposes, as shall be determined in Central Hudson's next rate case.

*c) Community Benefit Fund*

A total of \$5 million will be provided by Fortis for a Community Benefit Fund to be utilized for low income and economic development purposes as discussed in greater detail previously in this Joint Proposal.

## **B. Performance Mechanisms**

RUCO Fortis 1.04 Attachment A.pdf

### **1. Customer Service**

The following targets and effective dates will apply:

Measure	Value	Effective
PSC Complaint Rate	1.1 - 1.6	7/1/13
Customer Satisfaction Index	85 - 82, etc. structure per the current rate plan	7/1/13
Keeping Scheduled Appointments	\$20 paid to customer for missed appt. per current rate plan	7/1/13

These targets continue to apply unless and until changed by Commission Order.

### **2. Negative Revenue Adjustments ("NRAs")**

The NRAs shown in the following table have been doubled from those in the current rate plan. The NRAs in the current rate plan shall be tripled if targets are missed during a dividend restriction and quadrupled if targets are missed for three years within the next five year period. Central Hudson Service Quality Performance Mechanism

Customer Satisfaction Index	Negative Revenue Adjustment
85% or higher	None
84% - 85%	\$475,000
83% - 84%	\$950,000
82% - 83%	\$1,425,000
<82%	\$1,900,000
<b>Total Amount at Risk</b>	<b>\$1,900,000</b>

PSC Annual Complaint Rate	Negative Revenue Adjustment
<1.1	None
1.1	\$950,000
1.2	\$1,140,000
1.3	\$1,330,000
1.4	\$1,520,000
1.5	\$1,710,000
1.6 or higher	\$1,900,000
<b>Total Amount at Risk</b>	<b>\$1,900,000</b>

### **3. Electric Reliability**

The electric service annual metrics for System Average Frequency Index (SAIFI) target of 1.45 and Customer Average Duration Index (CAIDI) target of 2.50 continue through 2013.

Electric Reliability Reporting requirements, quarterly meeting requirements, revenue adjustment source, and exclusions are defined in Attachment II. All Electric Reliability NRAs of the current

rate plan shall be doubled. In addition, the NRAs of the current rate plan shall be tripled if targets are missed during a dividend restriction and quadrupled if targets are missed for three years within the next five year period. All electric reliability targets for calendar year 2013 remain in effect until modified by a Commission order in a subsequent Central Hudson electric rate case.

#### 4. Gas Safety Metrics

##### a) *Emergency Response Time*

The gas emergency response time metrics of 75% response within 30 minutes and 90% response within 45 minutes will be continued.

##### b) *Gas Leak Backlog*

The calendar year 2013 leak backlog target is 260 at year-end. The calendar year 2013 repairable leaks backlog target is 20 at year-end.

##### c) *Damage Prevention*

The calendar year 2013 total damages per 1,000 one call tickets target is 2.40. The calendar year 2013 mismarks per 1,000 one call tickets target is 0.50. The calendar year 2013 Company and Company Contractor damages per 1,000 one call tickets target is 0.25.

##### d) *New Parts 255 and 261 Violation Metric*

Central Hudson will incur a negative revenue adjustment for instances of noncompliance (violations) of certain pipeline safety regulations set forth in 16 NYCRR Parts 255 and 261, as identified during Staff's annual field and record audits. Attachment III sets forth a list of identified high risk and other risk pipeline safety regulations pertaining to this metric. Central Hudson will be assessed a negative revenue adjustment for each high risk or other risk violation, up to a combined maximum of 100 basis points per calendar year as follows:

High Risk Violation	Occurrences	Basis Points Per Violation
	1-30	1/4
Calendar Year 2013	31+	1/2
	1-25	1/2
Calendar Year 2014	26+	1
Other Risk Violation	Occurrences	Basis Points Per Violation
	1-30	1/9
Calendar Year 2013	31+	1/3
	1-25	1/9
Calendar Year 2014	26+	1/3

This metric will be effective as of the start of the Commission Order in this case, but will then be measured on calendar years, as identified above. With respect to violations, only documentation or actions performed, or required to be performed, on or after the date of the Commission Order in this case will constitute an occurrence under the metric.

At the conclusion of each audit, Staff and Central Hudson will have a compliance meeting where Staff will present its findings to Central Hudson. Central Hudson will have five business days from the date the audit findings are presented to cure any identified document deficiency. Only official Central Hudson records, as defined in Central Hudson's Operating and Maintenance plan, will be considered by Staff as a cure to a document deficiency. Staff will submit its final audit report to the Secretary of the Commission under Case 12-M-0192. If Central Hudson disputes any of Staff's final audit results, Central Hudson may appeal Staff's finding[s] to the Commission. Central Hudson will not incur a negative revenue adjustment on the contested finding until such time as the Commission has issued a final decision on the contested findings. Central Hudson does not waive its right to seek an appeal of any Commission determination regarding a violation under applicable law.

If an alleged high risk or other risk violation set forth in Attachment III is the subject of a separate penalty proceeding by the Commission under PSL 25, that instance will not constitute an occurrence under this performance metric.

*e) Negative Revenue Adjustments*

Other than the Parts 255 and 261 metric, all Gas Safety NRAs of the current rate plan shall be doubled. In addition, the NRAs of the current rate plan shall be tripled if targets are missed during a dividend restriction and quadrupled if targets are missed for three years within the next five year period.

*f) Continuation*

All gas safety targets for calendar year 2013 remain in effect until modified by a Commission order in a subsequent Central Hudson gas rate case.

**5. Infrastructure Enhancement for Leak-prone Pipe**

A minimum capital budget of \$7.7 million is established for the replacement of leak-prone pipe over calendar year 2014. The pipe to be removed from service shall be identified and ranked using a risk-based methodology. If actual expenditures fall short of \$7.7 million, Central Hudson will defer for ratepayer benefit the revenue requirement equivalent of the shortfall multiplied by 0.5. Central Hudson shall maintain the minimum pipe replacement level beyond 2014 at \$7.7 million, until changed by the Commission.

**6. Net Plant Targets**

Central Hudson's net plant targets for the twelve month period ending June 30, 2014 of \$919.3 million for Electric and \$252.2 million for Gas, with associated annual depreciation expenses of \$32.7 million and \$9.0 million, respectively, will be established.

The actual average electric and gas net plant balances at the end of the twelve month period ending June 30, 2014 will be calculated using the calculation methods described in Attachment III. The net plant targets shown in Attachment III limit total Common Software construction expenditures, including Legacy Replacements, in the Rate Freeze Period to \$5.0 million.

*a) Reconciliations*

The actual electric and gas net plant will be compared to the electric and gas net plant target for the twelve month period ending June 30, 2014, and the revenue requirement difference (i.e., return and depreciation as described in Attachment IV) will be determined.

*b) Deferral For the Benefit of Ratepayers*

If, at the end of the twelve month period ending June 30, 2014, the revenue requirement difference from net plant additions is negative, Central Hudson will defer the revenue requirement impact for the benefit of customers. If, at the end of the twelve month period ending June 30, 2014, the revenue requirement impact is positive, no deferral will be made. Carrying charges at the PTROR will be applied by the Company to the amount deferred from the end of the twelve month period ending June 30, 2014 until addressed by the Commission in a Central Hudson rate order.

**C. Low Income and Retail Access**

**1. Low Income**

Fortis and Central Hudson agree that the existing funding for low income programs available currently in rates will be supplemented with \$500,000 from the Community Benefit Fund being made available by the Petitioners as a result of this transaction. In addition, the Signatories agree to the following modifications to existing low income programs:

- a) Central Hudson's current low income program is made up of two components: the Enhanced Powerful Opportunities Program ("EPOP"), which is a targeted program open to selected participants, and a broad-based bill discount program that provides a monthly bill credit to all customers that are Home Energy Assistance Program ("HEAP") recipients. The EPOP program and its associated funding will remain unchanged. The bill discount program currently provides a monthly bill credit of \$11.00 to all customers who are HEAP recipients. Data provided by Central Hudson reflect that the program has 8,641 participants as of the twelve months ended November 30, 2012, and projected annual spending of \$1,140,612 (\$11 x 12 x 8,641).
- b) Within 30 days of a Commission order in this proceeding, Central Hudson will modify its current discount program, which provides dual-service customers with one discount, by implementing the following discount levels for single and dual service bill discount program participants:

	Electric only	Gas only	Both Elec. & Gas
Heating	\$17.50	\$17.50	\$23.00
Non-heating	\$5.50	\$5.50	\$11.00

- c) In order to ensure that no current participant faces a reduction in current benefit levels, any single service non-heating customer currently receiving a bill discount of \$11.00 will continue receiving such benefit at the \$11.00 level, instead of the \$5.50 level specified above.

- d) The total cost of the bill discount program is expected to be \$1,662,672. Actual expenditures may vary based on HEAP participation levels.
- e) Central Hudson will waive service reconnection fees, no more than one time per customer until new rates go into effect, for customers participating in either the EPOP or bill discount programs. Funding for reconnection fee waivers is limited to \$50,000 until new rates go into effect. Central Hudson may grant waivers to individual customers more than once during this period, on a case-by-case basis and for good cause shown, provided that the program funding allocation for such waivers is not exceeded. Upon notice to Staff and the UIU, Central Hudson will be permitted, first, to limit the waiver to (50) percent of the total reconnection fee, *if the cost of waived reconnection fees is projected to exceed the annual allocation, and*, second to suspend the waiver program if the budget limit is reached.
- f) A sum of \$500,000 of the total costs of the low income bill discount and reconnection fee waiver programs is to be supplied from the Community Benefit Fund. To the extent that actual expenditures exceed the rate allowance in current rates of \$1,531,200, plus \$500,000 from the Community Benefit Fund, any shortfall will be supplied first, from the cumulative unused portions of the current rate allowances for the bill discount program, which is expected to be approximately \$500,000, and second, will be deferred as a regulatory asset. To the extent that actual expenditures fall short of the current rate allowance plus the cumulative unused portions of the current rate allowances for the bill discount program plus \$500,000 from the Community Benefit Fund, any excess will be deferred for use of the low-income bill discount program and the reconnection fee waiver program in a future rate proceeding.
- g) Customers enrolled in the EPOP or low income bill discount programs will continue to be referred by Central Hudson to the New York State Energy Research and Development Authority's Empower-NY program or any successor to the Empower-NY program, for energy efficiency services.
- h) The parties agree that these modifications justify returning to a quarterly reporting schedule. Central Hudson will file quarterly and annual reports on the EPOP and bill discount programs with the Secretary and provide copies to other parties currently receiving copies of EPOP reports. With respect to the bill discount program, the reports will provide:
  - i. The number of customers enrolled in the bill discount program;
  - ii. The aggregate amounts of low-income bill discounts for the quarter and year to date; and
  - iii. The number of reconnections of low income customers for which the fee was fully or partially waived, and the aggregate amount of reconnection fees waived to date.
- i) Nothing in this Joint Proposal is intended to prejudge the treatment of low income matters by the Commission in Central Hudson's next rate case.



## **2. Retail Access**

In support of the Commission's retail market development initiatives, Central Hudson will set forth a total bill comparison, using the existing Central Hudson computer program that had been previously implemented, on all retail access residential bills using consolidated billing issued after 90 days following closing. The Signatories agree that this total bill comparison is to provide information to retail access customers that should be made available by the utility as part of the Commission's retail energy markets initiatives. Central Hudson shall report quarterly to the Secretary on this initiative so that Staff can continue to review and supervise this initiative and report any changes deemed desirable to the Commission on an on-going basis. Central Hudson's quarterly reports will also be provided to other parties currently receiving Central Hudson's EPOP reports.

In addition, for similar purposes of supporting the Commission's retail market development initiatives, within 60 days following issuance of the Commission Order in this case, Central Hudson will file a proposal to provide payment-troubled (i.e., subject to termination) customers with bill comparison information. The type of reporting and continued monitoring appropriate for this initiative will be developed as part of the resolution of Central Hudson's pending proposal.

The costs of these two initiatives will be funded from the existing Competition Education Fund (net of the transfer of funds for economic development, as described below). Central Hudson shall propose a use or uses for any balance remaining in the Competition Education Fund, after these two initiatives have been funded, in its first rate filing following the closing. In the event that the costs of these two initiatives exceed the funding available from the existing Competition Education Fund (net of the transfer of funds for economic development), Central Hudson is authorized to defer the excess costs for future recovery with carrying charges at the PTROR.

The Signatories anticipate that modifications to either initiative may become appropriate based on developments in the ongoing generic retail access proceeding, Case 12-M-0476.

## **D. Economic Development and Support for State Infrastructure Enhancements**

### **1. Economic Development**

The Signatories agree that \$5 million will be allocated to economic development purposes to enhance the existing Central Hudson economic development programs. The \$5 million is in addition to the current Central Hudson rate allowance for economic development funding. The funding for this program will be through \$4.5 million from the remaining balance of the \$5 million Community Benefit Fund being provided by Fortis and Central Hudson and \$500,000 from Central Hudson's Competition Education Fund.

The parties to this proceeding will confer following the execution and filing of this Joint Petition in this case to seek to jointly develop consensus modifications to the existing Central Hudson economic development programs. Central Hudson shall make a filing with the Commission within 15 days following the Commission's order in this case proposing modifications to the existing economic development programs that include the parties' agreements. As part of the

filing made by Central Hudson, expedited consideration by the Commission will be requested. The proposal will be for programs that will continue to be administered by Central Hudson pursuant to existing Commission authorizations, with the clarifications and modifications as follows. Central Hudson will continue to hold custody of funds and administer the programs with input from the Counties in Central Hudson's service territory. The \$5 million will not receive carrying charges. The proposal will include the criterion that all applications for projects that do not have participation from Empire State Development, a County Industrial Development Agency, a County Community College, or local municipal resolution pursuant to existing program requirements will seek a letter of support from the County of origin. In addition, the proposal will state that Central Hudson will seek participation concerning award notifications and announcements from the County of origin prior to issuing such announcements.

In addition to filing the above proposal, Central Hudson will meet twice per year with representatives from all of the Counties in the Central Hudson service territory to discuss economic development and potential program improvements. Nothing in this Joint Proposal is intended to prejudice the treatment of economic development matters by the Commission in Central Hudson's next rate case.

## **2. State Infrastructure Enhancements**

Central Hudson shall continue to support the New York State Transmission Assessment and Reliability Study ("STARS"), the Energy Highway and economically justified gas expansion. Fortis agrees to provide equity support to the extent required by Central Hudson for such projects as receive regulatory approval and proceed to construction.

## **3. Gas Expansion Pilot Program**

Central Hudson will commit to actively promote its "Simply Better" gas marketing expansion campaign in the Rate Freeze Period, seeking gas customer additions where Company gas facilities already exist, and economic expansion of its gas system, consistent with the Commission's Part 230 regulations, to identified expansion target areas in each operating district. The Company will continue to provide requesting and targeted customers with access to conversion calculators, third-party turnkey conversion services (potentially including a project specialist from start to finish, a licensed heating installation professional, a detailed cost/benefit proposal on converting their heating equipment, removal of existing oil tank, and coordination of the service and heating installations), and available financing from third-party lenders to assist customers who are seeking gas delivery service or to convert from alternate fuels.

In the event that adequate financial commitments can be secured from new firm service customers and municipal franchise approvals on reasonable conditions are secured in locations where Central Hudson does not currently have gas facilities or local franchises, Central Hudson will commit to file for expedited Commission approval to exercise such franchises as are shown by Central Hudson's analyses to comply with Part 230.

Central Hudson will begin, within 90 days of an Order in this proceeding approving this Joint Proposal, to track all gas service requests and keep record of: (1) applicable gas service request dates (i.e., customer request received, Company evaluation or commitment made, service denied/initiated); (2) the address of requested service including the township and county; (3)

calculated cost to install new service lines and main extensions including customer payment responsibility; and (4) reasons for a service not being initiated. Customer information will be protected consistent with the updated Standards addressed elsewhere in this Joint Proposal.

Central Hudson will propose applying a limited pilot expansion program aimed at testing ideas to economically expand gas to customers. The pilot can be either part of a new franchise filing or a separate filing to the Commission no later than July 1, 2013. The pilot will test all or any of the following ideas:

- a) Piggy back on top of anchor customers to reduce the actual need for additional pipe beyond the 100 foot rule;
- b) surcharge all customers or specific customers over five years or more based on the savings from their alternative fuel to write down assets in order to meet the overall Rate of Return (ROR) by year 5;
- c) increase the minimum 100 feet allowed by a higher "average" amount for everyone in the customer cluster to be served based on anticipated additional revenues; and/or
- d) Trade Alliance by Central Hudson to purchase heating equipment from manufacturers for conversion/new customers and pass the savings to customers.

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
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January 28, 2014**

**Post-transaction and tangible benefits.**

**UDR 1.36**

Please describe of the financial benefits that will accrue to UNS Gas, UNS Electric, and TEP as the result of the proposed transaction.

**RESPONSE:**

Anticipated cost savings include reduced or eliminated public company costs, reduced insurance costs, and a potentially lower cost of debt as a result of anticipated credit rating upgrades. For more details, please see the testimony of Kevin Larson at pages 2-10.

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
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**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.09**

The Fortis Inc. 2013 Annual Report at page 135 states that:

"Following the announcement of the proposed acquisition of UNS Energy on December 11, 2013, several complaints, which named Fortis and other defendants, were filed in the Superior Court of Arizona, Pima County, and the United States District Court of the District of Arizona, challenging the proposed acquisition. The complaints generally allege that the directors of UNS Energy breached their fiduciary duties in connection with the proposed acquisition and that UNS Energy, Fortis, FortisUS Inc. and Color Acquisition Sub Inc. aided and abetted that breach. The outcome of these lawsuits cannot be predicted with any certainty and, accordingly, no amount has been accrued in the consolidated financial statements. An adverse judgment for monetary damages could have a material adverse effect on the operations of the surviving company after the completion of the acquisition. A preliminary injunction could delay or jeopardize the completion of the acquisition and an adverse judgment granting permanent injunctive relief could indefinitely enjoin completion of the transaction. Subject to the foregoing, in management's opinion, based upon currently known facts and circumstances, the outcome of such lawsuits is not expected to have a material adverse effect on the consolidated financial condition of Fortis. The defendants intend to vigorously defend themselves against the lawsuits."

- a. How are such costs being accounted for (show journal entries and indicate on which entity's books such costs are being recorded)?
- b. Are any of these costs being charged to TEP, UNS Electric or UNS Gas? If so, identify the amounts charged to each utility to date by account.
- c. Does Fortis agree that none of the costs related to this litigation should be borne by the ratepayers of TEP, UNS Electric or UNS Gas?
  1. If not, explain fully why not.
  2. Will Fortis accept a condition that precludes the recovery of any of the costs of such litigation from ratepayers of TEP, UNS Electric or UNS Gas? If not, explain fully why not.
- d. Did Fortis or any of its subsidiaries incur any costs for shareholder litigation related to the acquisition by Fortis of CH Energy (Central Hudson) and its subsidiaries?
  1. If so, how were the costs of that litigation accounted for and on which entity's books were such costs recorded?

**RESPONSE:**

- a. The costs related to litigation referenced at page 135 of the Fortis Inc. 2013 Annual Report will be an expense on the books of UNS Energy. As noted in response to RUCO Fortis 2.22, Fortis anticipates injecting equity to fund acquisition related costs that are being expensed by UNS Energy.

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**April 4, 2014 (COMPLETE SET)**

- b. Yes. The merger related costs recorded on UNS Energy's books are allocated to subsidiaries using the allocation method described by UNS Energy in UDR 1.14. All merger related costs are tracked using identifiable accounting coding to allow them to be removed for rate making purposes from each subsidiary.
- c. Yes. Fortis agrees that none of the costs related to the litigation should be borne by the customers of TEP, UNS Electric or UNS Gas.
  - 1. Not Applicable
  - 2. Yes. Fortis has committed that transaction costs will not be recovered from customers through rates.
- d. Yes.
  - 1. The costs were accounted for as an expense on the books of CH Energy Group, Inc.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

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**January 28, 2014**

**UDR 1.33**

Please provide a description of the nature and current status of all litigation or anticipated litigation concerning the acquisition.

**RESPONSE:**

Five putative shareholder class action lawsuits challenging the merger have been filed, four in the Superior Court of Pima County, Arizona: (i) *Phillip Malenovsky v. UNS Energy Corporation, et al.* (Case No. C20136942); (ii) *Paul Parshall v. UNS Energy Corporation, et al.* (Case No. C20136943); (iii) *Hillary Kramer v. Paul J. Bonavia, et al.* (Case No. C2014-0026); and (iv) *Vandermeer Trust U/A DTD 03/11/1997 v. UNS Energy Corporation, et al.* (Case No. C2014-0107); and one in federal court in the United States District Court for the District of Arizona: *Milton Pfeiffer v. Paul J. Bonavia, et al.* (Case No. 4:13-CV-02619-JGZ).

All of the cases name the current directors of UNS Energy as defendants, and all name at least one or more Fortis entity as a defendant, including: FortisUS, Merger Sub, and Fortis. Each of the lawsuits has been brought by a purported shareholder of UNS Energy, both individually and on behalf of a putative class of UNS Energy shareholders.

The lawsuits generally allege, among other things, that the directors of UNS Energy breached their fiduciary duties to shareholders of UNS Energy purportedly by agreeing to a transaction pursuant to an inadequate process and for failing to obtain the highest value for UNS Energy shareholders. The *Malenovsky* lawsuit alleges further that the directors of UNS Energy also breached their fiduciary duties purportedly by failing to disclose all material information concerning the transaction and by engaging in self-dealing by approving the transaction. The *Malenovsky*, *Kramer*, and *Vandermeer Trust* lawsuits allege that UNS Energy aided and abetted the directors of UNS Energy in the alleged breach of their fiduciary duties. The lawsuits allege that the Fortis entities also aided and abetted the directors of UNS Energy in the alleged breach of their fiduciary duties.

The lawsuits seek, in general, and among other things, (i) injunctive relief enjoining the transactions contemplated by the merger agreement, (ii) rescission or an award of rescissory damages in the event a merger is consummated, (iii) an award of plaintiffs' costs including reasonable attorneys' and experts' fees, (iv) an accounting by the defendants to plaintiffs for all damages caused by the defendants, and (v) such further relief as the court deems just and proper. The *Vandermeer Trust* lawsuit also requests that the court direct the defendants to disclose all material information concerning the transaction.

These lawsuits are at a preliminary stage. UNS Energy, its directors and the other defendants believe that these lawsuits are without merit and intend to defend against them vigorously.

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**RESPONDENT:**

Todd C. Hixon

**WITNESS:**

David Hutchens

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
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February 28, 2014**

**RUCO UNS 1.02**

**Tax elections.** Will there be any Internal Revenue Code §338(h)(10) election in conjunction with this transaction?

- a. If so, please identify the estimated impacts of the §338(h)(10) election on each Arizona regulated utility's Accumulated Deferred Income Tax balances, showing the estimated (1) before and (2) after amounts of ADIT recorded on each such utility's books.

**RESPONSE:**

No §338(h)(10) election will be made in conjunction with this transaction.

**RESPONDENT:**

Frank Marino / Brian Brumfield

**WITNESS:**

Kevin Larson

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**January 28, 2014**

**UNS Energy and UNS Utilities – Capital Structure and Cost of Capital**

**UDR 1.08**

Please provide UNS Gas' current bond/debt rating.

**RESPONSE:**

UNS Gas' current senior unsecured rating is Baa2 from Moody's Investor Services ("Moody's").  
UNS Gas is not rated by Standard & Poor's ("S&P") or Fitch Ratings, Inc. ("Fitch").

**RESPONDENT:**

Chris Norman

**WITNESS:**

Kevin Larson

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**UDR 1.09**

Please provide UNS Electric's current bond/debt rating.

**RESPONSE:**

UNS Electric's current senior unsecured rating is Baa2 from Moody's. UNS Electric is not rated by S&P or Fitch.

**RESPONDENT:**

Chris Norman

**WITNESS:**

Kevin Larson

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**UDR 1.10**

Please provide TEP's current bond/debt rating.

**RESPONSE:**

The table below summarizes TEP's current bond ratings.

	<b>S&amp;P</b>	<b>Moody's</b>	<b>Fitch</b>
Senior Unsecured Debt	BBB	Baa2	BBB
Issuer Rating	BBB	Baa2	BBB-

**RESPONDENT:**

Chris Norman

**WITNESS:**

Kevin Larson

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**UDR 1.11**

Please provide UNS Energy's current bond/debt rating.

**RESPONSE:**

UNS Energy's current senior secured rating is Baa3 from Moody's. UNS Energy is not rated by S&P or Fitch.

**RESPONDENT:**

Chris Norman

**WITNESS:**

Kevin Larson

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**UDR 1.16**

Please provide Fortis Inc.'s current bond/debt rating.

**RESPONSE:**

Please see the testimony of Barry V. Perry at pages 3-4.

See also the files listed below for the S&P and DBRS ratings reports of Fortis.

File Name	Bates Numbers
UDR 1.16 DBRS - Fortis Inc (Feb 2013).pdf	000921-000928
UDR 1.16 SP - Fortis Inc - Feb 26, 2013.pdf	000929-000938

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

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UDR 1.16 DBRS - Fortis Inc (Feb 2013).pdf



## Rating Report

**Report Date:**  
February 19, 2013  
**Previous Report:**  
July 26, 2012

## Fortis Inc.

### Analysts

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### The Company

Fortis Inc. is a holding company for a number of regulated electric and natural gas utilities, including wholly owned FortisBC Energy companies (formerly Terasen Gas Inc. and Terasen Gas (Vancouver Island) Inc.), Newfoundland Power Inc., FortisAlberta Inc., FortisBC Inc., Maritime Electric Company, Limited, FortisOntario Inc. and Fortis Turks and Caicos, as well as majority ownership of Caribbean Utilities Company (slightly over 60%).

Non-regulated operations include Fortis Properties, as well as non-regulated generation in Belize, Ontario and upper New York State.

### Rating

Debt	Rating	Rating Action	Trend
Issuer Rating	A (low)	Confirmed	Stable
Unsecured Debentures	A (low)	Confirmed	Stable
Preferred Shares	Pfd-2 (low)	Confirmed	Stable

### Rating Update

DBRS has confirmed the Issuer Rating and ratings of the Unsecured Debentures and Preferred Shares of Fortis Inc. (Fortis or the Company) at A (low), A (low) and Pfd-2 (low), respectively, with Stable trends. The confirmation reflects the Company's strong mix of earnings generated from regulated utilities and reasonable financing strategies for the acquisition of CH Energy Group Inc. (CHG) (the Acquisition; approximately US\$1.5 billion, including US\$500 million assumed debt) and the Waneta hydropower project, of which Fortis has 51% ownership.

Upon completion of the Acquisition and Waneta project, Fortis' non-consolidated leverage is expected to increase modestly, but should be maintained within the 20% range as a result of a prudent funding mix. The 20% threshold is in line with DBRS's rating guidelines for notching a holding company relative to its subsidiaries (see DBRS's methodology *Rating Holding Companies and Their Subsidiaries*). In 2012, the Company completed its subscription receipt offering of approximately \$601 million and preferred shares issuance of approximately \$200 million, which will be used to partially fund the Acquisition and Waneta project (\$116 million in capital expenditures (capex) in 2013, net to Fortis). Although cash flow coverage is expected to weaken temporarily following the Acquisition and Waneta project, it is expected to remain within the current rating category (pro forma debt-to-capital of approximately 14% in 2012).

Fortis' business risk profile is expected to improve moderately with the Acquisition, as approximately 97% of CHG's earnings are generated from its regulated electric and gas businesses. This regulated earnings mix is higher than the Company's consolidated mix of approximately 90% (remainder generated from higher-risk hotel properties and non-regulated generation businesses). The regulatory framework in New York is viewed as reasonable, as CHG is allowed to recover prudently incurred operating, capital and commodity costs in a timely manner and earn a reasonable return on investments.

Fortis is currently rated the same as some of its subsidiaries (FortisBC Inc. and FortisAlberta Inc.), despite the structural subordination and double leverage at the parent, as DBRS believes that Fortis' ratings are supported by strong and stable cash flows from diversified sources, with a prominent portion of dividends coming from regulated subsidiaries with "A" ratings (FortisBC Energy Inc. and Newfoundland Power Inc.).

### Rating Considerations

#### Strengths

- (1) Strong and stable dividends and cash income
- (2) Diversified sources of cash flow
- (3) 100% ownership of most subsidiaries
- (4) Good liquidity/strong interest coverage

#### Challenges

- (1) Potential higher debt levels at the parent
- (2) Structural subordination to debt at the subsidiaries
- (3) Strong ring-fencing at its wholly owned utilities
- (4) Considerable capex for Waneta Expansion Project

### Financial Information

	USGAAP	CGAAP	CGAAP	CGAAP	CGAAP
	Year ended December 31				
Fortis Inc. - Non-consolidated (CAS millions)	2012	2011	2010	2009	2008
EBIT	418.5	414.9	379.3	344.4	320.2
EBIT interest coverage (times)	10.55	9.37	8.01	7.93	8.25
DBRS adjusted total debt	1,088.9	880.4	1,181.7	844.7	654.0
Total debt in capital structure	18.1%	15.7%	22.5%	17.7%	15.0%
Cash flow interest coverage (times)	5.52	4.90	3.27	4.86	3.58
Cash flow/Total debt	20.1%	24.6%	13.1%	25.0%	21.2%

UDR 1.16 DBRS - Fortis Inc. (Fortis)



**Fortis Inc.**

**Report Date:**  
February 19, 2013

## Rating Considerations Details

### Strengths

(1) **Strong and stable dividends and cash income.** Cash income and dividends have been strong, largely supported by stable earnings and cash flow from regulated entities and long-term power contracts. Regulated operations account for approximately 90% of consolidated earnings and 71% of non-consolidated cash flow in 2012.

(2) **Diversified sources of cash flow.** Fortis benefits from diversified sources of cash flow through its ownership of regulated natural gas utilities in British Columbia and electric utilities in five Canadian provinces and three Caribbean countries. This is expected to improve upon the completion of the CHG acquisition.

(3) **100% ownership of most subsidiaries.** Fortis owns 100% of most of its operating entities. This provides Fortis, within the boundaries of regulatory oversight, with some discretionary powers over the manner in which cash flows are paid to it by its operating companies.

(4) **Good liquidity/strong interest coverage.** At the end of December 31, 2012, Fortis had approximately \$991 million in available credit facilities (at the parent level), which is sufficient to finance its near-term operational and capital needs. Non-consolidated cash flow-to-interest coverage remained strong in 2012 at 5.52 times.

### Challenges

(1) **Potential higher debt levels at the parent.** Fortis' agreement to acquire CHG could considerably increase debt levels at the parent. As at December 31, 2012, the non-consolidated debt-to-capital ratio was at approximately 14% (pro forma), providing Fortis with financial flexibility. However, Fortis' non-consolidated leverage will likely increase to around the 20% threshold.

(2) **Structural subordination to debt at the subsidiaries.** Fortis is a holding company whose debt is structurally subordinated to the debt obligations of its operating companies. This accounts for the lower debt rating of Fortis relative to the debt ratings of some its key regulated subsidiaries.

(3) **Strong ring-fencing at its wholly owned utilities.** Fortis faces strong ring-fencings imposed on FortisBC Energy Inc. and FortisBC (Vancouver Island) Inc., with respect to their capital structure and dividend payouts. In addition, it is common for utilities to maintain their capital structure in line with the regulatory capital structure. As a result, dividend payouts to Fortis could be affected should these utilities have a large capital expenditure program.

(4) **Large capital expenditures for the Waneta Expansion Project (WEP).** The WEP is a hydroelectric project in British Columbia that is 51% owned by Fortis. The Company's share of capital expenditures is approximately \$450 million. Approximately \$436 million has been spent to date and a further \$227 million is expected to be spent in 2013 (51% contributed by Fortis). The project is expected to be in service in early 2015.

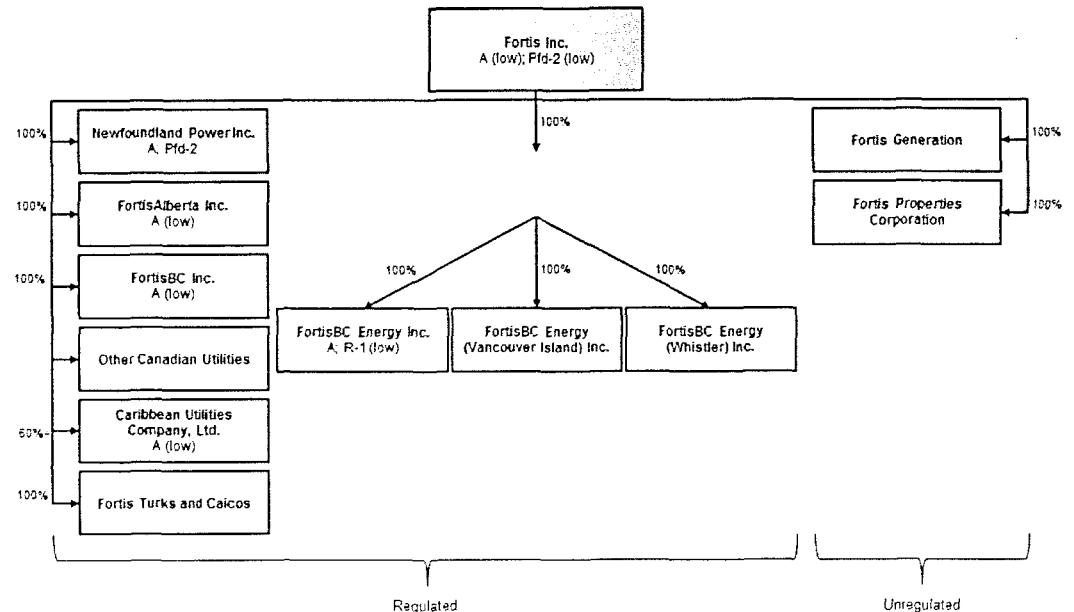




## Fortis Inc.

Report Date:  
February 19, 2013

## Simplified Corporate Structure\*



\*Note: The above chart only includes Fortis' major regulated and non-regulated subsidiaries, which directly or indirectly contribute dividends to Fortis.

## Based on 2012 Data

Name	Operation	Customers	Rate base (CAD billions)	Allowed ROE to 2012	Net Income (CAD millions)	Deemed equity
FortisBC Holdings Inc.	Holding company	945,000	3.6	9.50%-10.00%	138	40%
FortisBC Energy Inc.	Natural gas distribution	N/A	N/A	9.50%	N/A	40%
FortisBC Energy (Vancouver Island)	Natural gas distribution	N/A	N/A	10.00%	N/A	40%
FortisBC Energy (Whistler)	Natural gas distribution	N/A	N/A	10.00%	N/A	40%
FortisAlberta	Electricity distribution	508,000	2.0	8.75%	96	41%
FortisBC	Integrated utility	163,000	1.1	9.90%	50	40%
Newfoundland Power	Electricity distribution	251,000	0.9	8.80%	37	45%
Other Canadian Utilities	-	140,000	0.5	8.01%-9.850%	24	40%
Fortis Properties	Real estate	N/A	N/A	N/A	22	N/A
Caribbean Electric Utilities	Integrated utility	39,000	0.6	7.25%-17.50%	19	N/A
Fortis Generation	Power generation	N/A	N/A	N/A	17	N/A
Corporate and Other	-	N/A	N/A	N/A	(88)	N/A

## The Proposed Acquisition of CHG

On February 21, 2012, Fortis announced that it had agreed to acquire CHG for a total consideration of approximately US\$1.5 billion, including the assumption of US\$500 million of debt on closing. The Acquisition is expected to close in the second quarter of 2013, subject to various regulatory approvals. To date, CHG shareholders have approved the Acquisition, with a Settlement Agreement filed in January 2013. The parties to the Settlement Agreement, which provides almost \$50 million to fund customer and community benefits, have concluded that the Acquisition is in the public interest and have recommended approval by the New York State Public Service Commission.

CHG's principal businesses comprise: (1) Central Hudson Gas & Electric Corporation (Central Hudson), a regulated utility in New York state with approximately 300,000 electric customers and 75,000 gas customers, and (2) a non-regulated fuel delivery business (3% of CHG income), serving 56,000 customers in the Mid-Atlantic Region. Central Hudson accounts for 97% of CHG's 2011 net income and 93% of its assets. CHG's total assets as of December 31, 2011, were US\$1.7 billion. Net income and operating cash flow in 2011 were US\$45 million and US\$115 million, respectively.



**Fortis Inc.**

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**Waneta Expansion Project**

WEP, a 335 MW expansion of the hydroelectric generating facility on the Pend d'Oreille River in British Columbia, is the largest capital project currently underway. It is expected to come into service in early 2015 at a cost of around \$900 million, 51% of which Fortis will be responsible for, due to its ownership interest (remainder owned by Columbia Power Corporation (32.5%) and Columbia Basis Trust (16.5%)). By the end of 2012, approximately \$436 million has been spent in total and a further \$227 million is expected to be spent in 2013 (approximately \$116 million by Fortis). WEP is currently on time and on budget. The Company issued \$200 million of preferred shares in 2012 to repay borrowings under its committed corporate credit facility, which borrowings were primarily incurred to support the construction of WEP.

Although the facility is non-regulated, it will be included in the Canal Plan Agreement and will receive fixed energy and capacity entitlements based on long-term average water flows. In the long-term energy purchase agreement with the British Columbia Hydro & Power Authority (rated AA (high); see rating report dated August 15, 2012), approximately 630 GWh and associated capacity required to deliver such energy have been contracted. The remaining capacity, approximately 234 MW, is expected to be sold to FortisBC Inc. (rated A (low); see rating report dated August 9, 2012) under a long-term capacity purchase agreement.

**Non-Consolidated Earnings & Cash Flows**

	USGAAP	CGAAP	CGAAP		
Earnings - Non-Consolidated	Year end December 31				
(C\$ millions)	2012	2011	2010		
Newfoundland Power	36.8	33.9	35.2		
FortisOntario	11.6	9.8	9.3		
FortisWest	103.3	83.5	81.9		
FortisBC Holdings	127.3	128.6	118.9		
Fortis Cayman Inc.	0.0	(0.0)	1.4		
Fortis Energy Bermuda Limited	25.0	26.0	28.2		
Regulated investment income	303.9	281.7	274.9		
Fortis Energy Cayman Inc.	14.5	14.6	18.0		
FOG Partnership	(0.3)	-	-		
FortisUS Inc.	(7.0)	11.9	(3.1)		
Fortis Properties	34.4	34.9	36.8		
52905 Newfoundland and Labrador	0.1	0.1	0.2		
Non-regulated investment income	41.7	61.5	52.0		
Total investment income	345.6	343.1	326.9		
Interest income + Management fee	82.8	77.2	59.6		
Total income	428.4	420.3	386.5		
Operating expenses	(7.9)	(3.9)	(5.9)		
EBITDA	420.4	416.4	380.6		
	USGAAP	CGAAP	CGAAP	CGAAP	CGAAP
Earnings - Non-Consolidated	Year end December 31				
(C\$ millions)	2012	2011	2010	2009	2008
EBITDA	420.4	416.4	380.6	346.1	322.8
Depreciation	(1.9)	(1.5)	(1.3)	(1.7)	(2.5)
EBIT	418.5	414.9	379.3	344.4	320.2
Interest expense	(39.7)	(44.3)	(47.4)	(43.4)	(38.8)
EBT before extra items	377.0	371.6	332.0	293.6	272.5
Taxes	(17.0)	(6.9)	(2.7)	(1.6)	(3.5)
Net income bef. extra items and pref. dividends	359.9	364.7	329.2	292.1	269.0
Reported net income bef. pref. dividends	361.8	363.7	329.2	297.0	274.9

UDR 1.16 DBRS - Fortis (Term B) 2013-2017



Fortis Inc.	Cash flow - Non-Consolidated (CAS millions)	USGAAP	CGAAP	CGAAP	CGAAP	CGAAP
		2012	2011	2010	2009	2008
Report Date: February 19, 2013	Net income bef. extra items and pref. dividends	359.9	364.7	329.2	292.1	269.0
	Depreciation & amortization	1.9	2.0	1.3	1.7	2.5
	Equity investments	(168.8)	(164.3)	(188.1)	(89.8)	(141.6)
	Deferred income taxes and others	25.8	14.6	12.3	7.4	8.9
	<b>Cash flow from operations</b>	<b>218.8</b>	<b>216.9</b>	<b>154.7</b>	<b>211.3</b>	<b>138.9</b>
	Common dividends paid	(169.6)	(151.2)	(135.3)	(132.8)	(162.1)
	Preferred dividends paid	(45.4)	(45.4)	(44.7)	(34.8)	(30.1)
	Capex	(9.1)	(4.0)	(3.3)	(0.2)	(0.3)
	<b>Free cash flow (bef. work. cap. changes)</b>	<b>(5.4)</b>	<b>16.3</b>	<b>(28.5)</b>	<b>43.5</b>	<b>(53.6)</b>
	Changes in non-cash work. cap.	0.2	2.8	(1.2)	(30.3)	6.4
	<b>Net free cash flow</b>	<b>(5.2)</b>	<b>19.1</b>	<b>(29.7)</b>	<b>13.2</b>	<b>(47.2)</b>
	Acquisitions & long-term investments	(115.8)	(79.4)	(376.8)	(358.1)	(306.2)
	Short-term investments	-	-	-	-	-
	Proceeds on asset sales	-	0.0	10.1	-	-
	Net equity change	218.4	345.0	264.5	49.0	533.1
	Net debt change	52.5	(165.0)	140.6	292.7	(179.0)
	DBRS adjustments, advances and others	(147.7)	(129.3)	(0.2)	4.9	6.0
	<b>Change in cash</b>	<b>2.2</b>	<b>(9.6)</b>	<b>8.4</b>	<b>1.7</b>	<b>6.7</b>

#### 2012 Summary

- Overall, Fortis has benefited from good earnings diversification, underpinned by its investments in regulated utilities, which account for approximately 71% of earnings in 2012.
- The relatively stable EBITDA is reflective of the Company's strong earnings from regulated utilities, contracted generation facilities, property management and interest income.
- Earnings continued to increase over the years, as a result of higher ROE in recent years and growing rate bases among the utilities.
- Fortis Properties' performance has been relatively stable over the past two years, reflecting the recovery of the Canadian economy.
- Cash flow from operations has remained relatively stable. The bulk of the cash flow from operations is distributed as dividends to common and preferred shareholders.
- The Company has continued to fund business acquisitions and investments, with a mix of debt and equity (including preferred shares) in a manner that maintains its credit ratios within the A (low) rating category.

#### 2013 Outlook

- Investment income from regulated utilities is expected to increase considerably in 2013, should the proposed Acquisition of CHG be completed as expected in the second quarter of 2013.
- DBRS also expects the Acquisition to improve Fortis' earnings diversification.
- Non-regulated earnings are expected to increase in 2015, when WEP is scheduled to be in service. The project has obtained a long-term power contract with BC Hydro.



**Fortis Inc.**

**Report Date:**  
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**Capital Structure and Liquidity**

**Capital Structure - Non-Consolidated**

(C\$ millions)	As at December 31				
	2012	2011	2010	2009	2008
Short-term debt	-	-	-	100	-
Credit facilities	53	-	165	125	32
Long-term debt	747	759	742	564	524
Sub. convertible debentures	-	-	42	44	50
Preferred shares	1,108	912	912	667	667
Common equity	4,000	3,867	3,308	3,195	3,046
<b>Total non-consolidated capital</b>	<b>5,907</b>	<b>5,538</b>	<b>5,169</b>	<b>4,695</b>	<b>4,319</b>
Total debt in capital structure	18.1%	15.7%	22.5%	17.7%	15.0%
EBIT interest coverage (times)	10.55	9.37	8.01	7.93	8.25
Cash flow interest coverage (times)	5.52	4.90	3.27	4.86	3.58
Cash flow/Total debt	20.1%	24.6%	13.1%	25.0%	21.2%

**Summary**

- Fortis' non-consolidated balance sheet remained strong in 2012, reflecting a debt-to-capital ratio of 18.1% (not including equity subscription of approximately \$601 million, which, if included, could reduce the ratio to around 14%), which provides the Company with some financial flexibility.
- This leverage remained well within the 20% threshold in DBRS's notching guidelines for a holding company relative to its subsidiaries.
- Cash flow-to-interest coverage remained strong for a holding company, at 5.52 times.

**Potential Impact of the Proposed Acquisition of CHG**

- The price of the Acquisition is approximately \$1.5 billion (including US\$500 million of assumed debt).
- In June 2012, Fortis completed a subscription receipt offering for approximately \$601 million, which will be used to partially finance the Acquisition, with the remainder expected to be financed with debt and preferred shares.
- Based on the Company's financing strategy, the debt-to-capital ratio will likely increase from the current level should the Acquisition be completed.
- The new debt-to-capital ratio is expected to remain within the 20% level.

**Liquidity**

Credit Facilities as at December 31, 2012

(\$ millions)	HoldCo & other	Subsidiaries	Subsidiaries	Total		
Total credit facilities	1,045	1,402	13	2,460		
Drawing on credit facilities (S-T)	-	(136)	-	(136)		
Drawing on credit facilities (L-T)	(53)	(97)	-	(150)		
Letters of credit	(1)	(66)	-	(67)		
Credit facilities available	991	1,103	13	2,107		
Debt maturities - (\$ millions)	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>Thereafter</u>
Fortis Inc. senior debt	0	149	0	0	0	598
Total	0	149	0	0	0	598
% of total debt	0%	20%	0%	0%	0%	80%

- Fortis has approximately \$4 million in cash and cash equivalents as at December 31, 2012.
- Fortis has sufficient liquidity to finance its near-term funding requirements.
- Debt maturity is concentrated in 2014, when 20% of Fortis' total debt is due. DBRS believes that the refinancing of this amount is within the Company's capacity, given its strong credit profile.



**Fortis Inc.**

**Report Date:**  
February 19, 2013

**Description of Operations**

Fortis' main subsidiaries and investments are as follows:

**FortisBC Holdings Inc. (100% owned)** is a holding company for the following utilities:

(1) **FortisBC Energy Inc. (FEI)** is the largest natural gas distributor in British Columbia, serving residential, commercial and industrial customers in an area extending from Vancouver to the Fraser Valley and the interior of British Columbia.

(2) **FortisBC Energy (Vancouver Island) Inc. (FEVI)** owns a combined distribution and transmission system, serving residential, commercial and industrial customers along the Sunshine Coast and in Victoria and various communities on Vancouver Island.

(3) **FortisBC Energy (Whistler) Inc. (FEW)** owns and operates a propane distribution system in Whistler, British Columbia, and provides service to residential and commercial customers.

**FortisAlberta Inc. (100% owned)** is a regulated electricity distributor with a franchise area that includes central and southern Alberta, the suburbs surrounding Edmonton and Calgary, Red Deer, Lethbridge and Medicine Hat.

**FortisBC Inc. (100% owned)** is a vertically integrated regulated utility operating in south-central British Columbia. Its generation assets include four hydroelectric generating plants (totaling 223 MW) on the Kootenay River in south-central British Columbia.

**Newfoundland Power Inc. (100% owned) (NP)** is a principal distributor of electricity on the island portion of Newfoundland and Labrador. Fortis also owns 25% of NP's preferred shares.

**Other Canadian Utilities**

(1) **FortisOntario Inc.** is an integrated electric utility providing services to customers in Fort Erie, Cornwall, Gananoque, Port Colborne and the District of Algoma in Ontario. FortisOntario also owns a 10% interest in each of Westario Power Inc., Rideau St. Lawrence Holdings Inc. and Grimsby Power Inc., three regional electric distribution companies.

(2) **Maritime Electric Company Limited (Maritime Electric)** is the principal distributor of electricity on Prince Edward Island. It also maintains on-island generating facilities with a combined capacity of 150 MW. Maritime Electric is indirectly owned by Fortis through FortisWest.

**Fortis Properties Corporation** owns and operates 23 hotels in eight Canadian provinces and approximately 2.8 million square feet of commercial real estate, primarily in Atlantic Canada. In October 2012, Fortis Properties acquired the 126-room StationPark All Suite Hotel in London, Ontario, for approximately \$13 million, inclusive of approximately \$6 million of debt.

**Caribbean Utilities Company, Ltd. (Caribbean Utilities)** is a fully integrated electricity utility on Grand Cayman, Cayman Islands with an installed generating capacity of approximately 151 MW. Fortis has an approximate 60% controlling ownership interest in Caribbean Utilities, with the remaining ownership publicly traded on the Toronto Stock Exchange.

**Fortis Turks and Caicos** serves approximately 85% of electricity consumers in the Turks and Caicos Islands, pursuant to 50-year licenses that expire in 2036 and 2037. The Company has a combined diesel-fired generating capacity of 54 MW.

**Belize Electric Company Limited** is a non-regulated 32 MW hydro generation facility in Belize. All output is sold to Belize Electricity Limited under a 50-year power purchase agreement expiring in 2055. The US\$53 million 19 MW hydroelectric generating facility at Vaca in Belize was commissioned in March 2010.

**Belize Electricity Limited** is recorded as equity investment following the expropriation by the Government of Belize in June 2011.

UDR 1.16 DBRS - For



## Fortis Inc.

Report Date:  
February 19, 2013

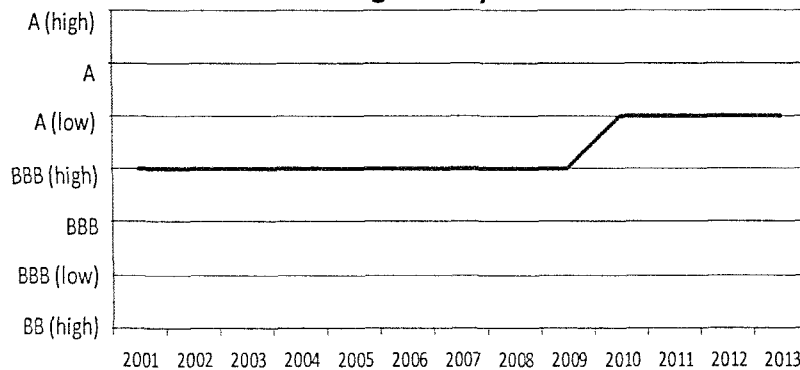
## Rating

Debt	Rating	Rating Action	Trend
Issuer Rating	A (low)	Confirmed	Stable
Unsecured Debentures	A (low)	Confirmed	Stable
Preferred Shares	Pfd-2 (low)	Confirmed	Stable

## Rating History

	Current	2012	2011	2010	2009	2008
Issuer Rating	A (low)	A (low)	NR	NR	NR	NR
Unsecured Debentures	A (low)	A (low)	A (low)	A (low)	BBB (high)	BBB (high)
Preferred Shares	Pfd-2 (low)	Pfd-2 (low)	Pfd-2 (low)	Pfd-2 (low)	Pfd-3 (high)	Pfd-3 (high)

## Rating History of Fortis Inc.



### Note:

All figures are in Canadian dollars unless otherwise noted.

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## Fortis Inc.

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Business Risk

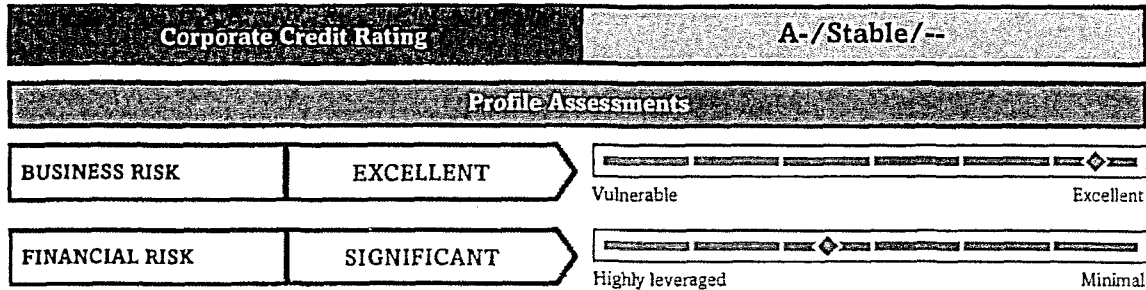
Financial Risk

Liquidity

Reconciliation

Related Criteria And Research

## Fortis Inc.



### Rationale

Business Risk: Excellent	Financial Risk: Significant
<ul style="list-style-type: none"> <li>• Low risk, and regulated assets</li> <li>• Limited commodity price and volume risk exposure</li> <li>• Diversified portfolio of regulated utilities</li> <li>• Monopoly service providers</li> </ul>	<ul style="list-style-type: none"> <li>• Stable regulated cash flow</li> <li>• High levels of leverage</li> </ul>

### Outlook: Stable

The stable outlook reflects Standard & Poor's Ratings Services' assessment of the operating companies' underlying operational and financial stability, which mitigates the relatively weak financial measures for the ratings.

#### Downside scenario

We could lower the ratings if Fortis Inc. were to employ more leverage or if it were to invest in assets with materially higher business risks and cash flow variability, one of its larger subsidiaries encountered major financial or operational difficulties or if the company experiences material challenges in completing its Waneta project on time and budget. We could also lower the ratings if company-level adjusted funds from operations (AFFO)-to-debt remains below 20% in 2015 or if consolidated AFFO-to-debt falls below 10%.

#### Upside scenario

A positive outlook or upgrade during our two-year forecast horizon is unlikely, given Fortis' weak credit metrics.

### Standard & Poor's Base-Case Scenario

Our base case scenario results in limited headroom above existing credit metric thresholds until the Waneta project is completed.



Fortis Inc.

UDR 1.16 SP - Fortis Inc - Feb 26, 2013.pdf

Assumptions	Key Metrics																
<ul style="list-style-type: none"><li>• The regulated utilities continue to generate stable cash flow</li><li>• Fortis does not experience any adverse regulatory decisions</li><li>• The company continues to finance its regulated utilities in line with allowed capital structure as established by related regulators.</li><li>• The acquisition of CH Energy Group Inc. is completed in second-quarter 2013 and the Waneta hydroelectric project is completed on time and on budget in the first half of 2015.</li></ul>	<table><tr><th>(%)</th><th>2012A</th><th>2013E</th><th>2014E</th></tr><tr><td>Consolidated AFFO/debt</td><td>11</td><td>10-12</td><td>10-12</td></tr><tr><td>Consolidated AFFO/interest</td><td>2.8</td><td>2.5-3.0</td><td>2.5-3.0</td></tr><tr><td>Deconsolidated AFFO/debt</td><td>25-27</td><td>18-20</td><td>18-20</td></tr></table> <p>Note: 2012 actual is based on 2012 reported results with 2011 adjustments. 2012 adjustments are not yet available. AFFO—Adjusted funds from operations. A—Actual, E—Estimated.</p>	(%)	2012A	2013E	2014E	Consolidated AFFO/debt	11	10-12	10-12	Consolidated AFFO/interest	2.8	2.5-3.0	2.5-3.0	Deconsolidated AFFO/debt	25-27	18-20	18-20
(%)	2012A	2013E	2014E														
Consolidated AFFO/debt	11	10-12	10-12														
Consolidated AFFO/interest	2.8	2.5-3.0	2.5-3.0														
Deconsolidated AFFO/debt	25-27	18-20	18-20														

## Company Description

Fortis is a holding company with 100% interests in a number of regulated utilities in Canada that account for about 85% of consolidated earnings. The company also has regulated utility assets in the Caribbean (5% of earnings) and unregulated power generation assets and a property segment each contributing about 5% of earnings.

## Business Risk: Excellent

Fortis' business risk continues to benefit from its stable, low risk, regulated utility portfolio. Regulation typically employs a cost-of-service methodology that provides an allowed regulated rate of return. The utilities typically have relatively low levels of commodity and volume risk exposure, further reducing cash flow volatility. Fortis' regulated companies are monopoly service providers in the territories they serve with limited bypass risk and are not exposed to typical market forces, which we also view as a key credit strength.

In our view, a key ongoing credit strength for the company is the regulatory, geographic, and market diversification of its subsidiaries and their cash flow. There continues to be some concentration in British Columbia, where about 50% of the rate base, including the CH Energy acquisition, is located.

The unregulated businesses make a relatively small consolidated contribution to the group. The size and quality of these cash flows will improve with the Waneta project's completion. This project has limited hydrology and price risk, no dispatch risk and strong counterparties in British Columbia Hydro & Power Authority and FortisBC.

Insulating provisions restrict Fortis' access to assets at some of its subsidiaries, enabling stronger subsidiaries to have a higher rating than the parent and limiting the support these entities could be forced to provide to the parent. This, combined with structural subordination of holdco debt, provides a key rationale for our deconsolidated analysis.

### S&P Base-Case Operating Scenario

- The regulated utilities continue to generate stable cash flow.
- The company does not experience any material adverse regulatory decisions
- The C\$900 million Waneta project is completed on time and budget
- The CH Energy Acquisition will close in second-quarter 2013

### Peer comparison

Table 1

Fortis Inc. - Peer Comparison					
Industry Sector: Electric Utility					
(Mil. C\$)	Fortis Inc.	Enbridge Inc.	TransCanada PipeLines Ltd.	CU Inc.	EPCOR Utilities Inc.
Rating as of Feb. 26, 2013	A-/Stable/-	A-/Stable/-	A-/Stable/A-2	A/Stable/A-1	BBB+/Stable/-
--Average of past three fiscal years--					
Revenues	3,685.3	22,495.3	7,970.0	1,629.4	1,861.7
EBITDA	1,222.3	2,996.2	4,242.9	750.3	350.1
Net income from continuing operations	349.7	926.7	1,380.3	273.4	125.7
Funds from operations (FFO)	786.8	2,817.7	3,111.2	537.6	291.3
Capital expenditures	1,014.9	3,781.0	3,132.1	799.0	415.3
Dividends paid	210.8	837.0	1,298.7	28.3	152.2
Debt	6,963.1	19,593.9	24,308.2	3,445.0	1,916.8
Preferred stock	673.3	1,432.5	591.7	210.3	0.0
Equity	4,454.5	11,138.0	18,393.9	2,314.8	2,385.2
Debt and equity	11,417.6	30,731.9	42,702.1	5,759.8	4,302.0
Adjusted ratios					
EBITDA margin (%)	33.2	13.3	53.2	46.0	18.8
EBIT interest coverage (x)	2.1	2.3	2.1	2.5	2.1
FFO interest coverage (x)	2.4	4.0	3.1	3.6	2.8
FFO/debt (%)	11.3	14.4	12.8	15.6	15.2
Discretionary cash flow/debt (%)	(5.5)	(10.4)	(5.1)	(8.8)	(17.0)
Net cash flow/capex (%)	56.8	52.4	57.9	63.7	33.5
Total debt/debt plus equity (%)	61.0	63.8	56.9	59.8	44.6
Return on capital (%)	6.9	7.2	6.8	9.2	7.0
Return on common equity (%)	8.2	8.7	5.8	11.2	4.8
Common dividend payout ratio (unadjusted; %)	62.0	86.7	86.6	13.0	109.1

### Financial Risk: Significant

We expect cash flow from the regulated utilities to remain very stable, a factor we believe is a key credit strength that offsets high leverage. Regulated utility cash flow is primarily composed of a return of capital (depreciation) and a

return on capital and return on equity, both of which continue to experience limited volatility. We expect consolidated leverage to remain high, with limited headroom above thresholds we associate with the ratings. Consolidated leverage is a function of the regulatory capital structure of the underlying utilities that generally follows levels allowed by regulation.

We expect deconsolidated credit metrics to deteriorate in 2013 and 2014 but improve dramatically with the completion of the Waneta project in 2015. We expect deconsolidated credit metrics in 2013 and 2014 to deteriorate as a result of the CH Energy acquisition and the largely debt-financed Waneta project.

Deconsolidated credit metrics are not as stable owing to the residual nature of cash flow from regulated utilities and the larger contribution of unregulated businesses.

Fortis achieves its growth targets through a mixture of growth in organic rate base and acquisitions. Mergers and acquisitions are typically riskier and material acquisitions can stress the financial risk profile. The company has a long history of increasing its dividends and would likely be very reluctant to reduce its dividends to support credit quality.

#### Stable Base-Case Cash Flow And Capital Structure Scenario

- The company experiences growth in rate base of about 15% in 2013, including the CH Energy acquisition
- Subsequent rate base growth returns to midsingle digits
- Growth in rate base leads to a corresponding growth in cash flow
- The company continues to finance its regulated utilities in line with allowed capital structure as established by related regulators
- Depreciation rates are stable
- The utilities continue to earn their allowed returns
- Ongoing use of the dividend reinvestment program raising about C\$100 million per year

#### Financing the CH Energy acquisition

- Fortis has issued C\$600 million in subscription receipts
- It also issued C\$200 million in preferred shares in fourth-quarter 2012 that received intermediate equity treatment and plans to issue a further C\$100 million-C\$150 million in preferred shares in 2013
- The company will assume about C\$500 million in debt
- It will fund the balance with debt drawn on committed facilities

#### Financial summary

Table 2

Fortis Inc. - Financial Summary					
Industry Sector: Electric Utility					
	--Fiscal year ended Dec. 31--				
(Mil. C\$)	2012	2011	2010	2009	2008
Rating history	A-/Stable/-	A-/Stable/-	A-/Stable/-	A-/Stable/-	A-/Stable/-
Revenues	3,654.0	3,738.0	3,664.0	3,637.0	3,903.0
EBITDA	1,302.7	1,229.7	1,177.2	1,085.0	1,064.7
Net income from continuing operations	362.0	357.0	330.0	297.0	276.0

Fortis Inc.

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Table 2

<b>Fortis Inc. - Financial Summary (cont.)</b>					
Funds from operations (FFO)	834.9	764.9	716.6	656.7	648.4
Capital expenditures	1,020.0	1,069.9	954.9	927.0	822.1
Dividends paid	225.0	183.0	224.5	160.5	185.5
Debt	7,593.3	7,407.3	6,895.9	6,591.5	6,159.9
Preferred stock	554.0	456.0	456.0	333.5	333.5
Equity	4,594.0	4,225.0	3,728.5	3,497.4	3,385.5
Debt and equity	12,741.3	12,088.2	10,624.4	10,088.9	9,545.4
<b>Adjusted ratios</b>					
EBITDA margin (%)	35.7	32.9	32.1	29.8	27.3
EBIT interest coverage (x)	1.9	1.9	1.9	1.9	1.8
FFO interest coverage (x)	2.8	2.7	2.7	2.7	2.7
FFO/debt (%)	11.0	10.3	10.4	10.0	10.5
Discretionary cash flow/debt (%)	(4.0)	(4.8)	(6.7)	(7.2)	(5.2)
Net cash flow/capex (%)	62.3	56.2	51.5	53.5	56.3
Debt/debt and equity (%)	62.3	63.7	64.9	65.3	64.5
Return on capital (%)	6.4	7.2	7.1	7.2	7.7
Return on common equity (%)	8.1	8.7	7.9	7.8	7.6
Common dividend payout ratio (unadjusted, %)	53.8	48.6	85.6	50.8	70.1

## Liquidity: Adequate

Fortis' liquidity is adequate, in our view. At the holding company level, we expect that liquidity sources will be sufficient to cover uses more than 1.2x. We expect that in the event of a 15% decline in deconsolidated earnings, Fortis' sources of funds would still exceed its uses. In our view, the company has sound relationships with its banks and generally satisfactory standing in credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>Expected remitted cash flows from Fortis' subsidiaries of about C\$400 million per year</li> <li>Unused committed credit facilities of about C\$975 million as of Dec. 31, 2012</li> </ul>	<ul style="list-style-type: none"> <li>Primarily interest and preferred share dividends of about C\$100 million</li> <li>Capital spending and dividends to shareholders of about C\$500 million (excluding the CH Energy acquisition), but we believe that some of the capital spending has some deferability</li> </ul>

## Debt maturities

Table 3

<b>Fortis Inc. - Debt Maturities (Mil. C\$)</b>	
2013	117
2014	702
2015	152

Table 3

Fortis Inc. -- Debt Maturities (Mil. C\$) (cont.)	
2016	294
Thereafter	4,477

## Reconciliation

Table 4

Reconciliation Of Fortis Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. C\$)										
--Fiscal year ended Dec. 31, 2012--										
Fortis Inc. reported amounts	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	6,471.0	5,100.0	3,654.0	1,264.0	794.0	366.0	938.0	938.0	225.0	1,020.0
Standard & Poor's adjustments										
Operating leases	118.9	N/A	N/A	6.7	6.7	6.7	14.8	14.8	N/A	31.9
Intermediate hybrids reported as equity	554.0	(554.0)	N/A	N/A	N/A	23.0	(23.0)	(23.0)	(23.0)	N/A
Postretirement benefit obligations	318.3	(262.0)	N/A	28.0	28.0	10.0	2.1	2.1	N/A	N/A
Capitalized interest	N/A	N/A	N/A	N/A	N/A	19.0	(19.0)	(19.0)	N/A	(19.0)
Share-based compensation expense	N/A	N/A	N/A	4.0	N/A	N/A	N/A	N/A	N/A	N/A
Asset retirement obligations	245.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Reclassification of nonoperating income (expenses)	N/A	N/A	N/A	N/A	19.0	N/A	N/A	N/A	N/A	N/A
Reclassification of working-capital cash flow changes	N/A	N/A	N/A	N/A	N/A	N/A	N/A	(78.0)	N/A	N/A
Minority interests	N/A	208.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Debt--other	(115.0)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total adjustments	1,122.3	(608.0)	0.0	38.7	53.7	58.7	(25.1)	(103.1)	(23.0)	12.9
Standard & Poor's adjusted amounts										
Adjusted	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	7,593.3	4,492.0	3,654.0	1,302.7	847.7	424.7	912.9	834.9	202.0	1,032.9

Table 4

**Reconciliation Of Fortis Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. C\$) (cont.)**

N/A--Not  
applicable.

**Related Criteria And Research**

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria Methodology: Differentiating The Issuer Credit Ratings Of A Regulated Utility Subsidiary And Its Parent, March 11, 2010
- Key Credit Factors: Business And Financial Risks In The Investor-Owned Utilities Industry, Nov. 26, 2008
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

**Business And Financial Risk Matrix**

Business Risk	Financial Risk					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA/AA+	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

**Note:** These rating outcomes are shown for guidance purposes only. The ratings indicated in each cell of the matrix are the midpoints of the likely rating possibilities. There can be small positives and negatives that would lead to an outcome of one notch higher or lower than the typical matrix outcome. Moreover, there will be exceptions that go beyond a one-notch divergence. For example, the matrix does not address the lowest rungs of the credit spectrum (i.e., the 'CCC' category and lower). Other rating outcomes that are more than one notch off the matrix may occur for companies that have liquidity that we judge as "less than adequate" or "weak" under our criteria, or companies with "satisfactory" or better business risk profiles that have extreme debt burdens due to leveraged buyouts or other reasons. For government-related entities (GREs), the indicated rating would apply to the standalone credit profile, before giving any credit for potential government support.

**Ratings Detail (As Of February 26, 2013)**

**Fortis Inc.**

Corporate Credit Rating	A-/Stable/--
Preference Stock	
Canadian Preferred Stock Rating Scale	P-2
Preferred Stock	
Canadian Preferred Stock Rating Scale	P-2
Preferred Stock	BBB
Senior Unsecured	A-

**Corporate Credit Ratings History**

23-May-2012	A-/Stable/--
22-Feb-2012	A-/Watch Neg/--
19-Jun-2007	A-/Stable/--

*Fortis Inc.*

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**Ratings Detail (As Of February 26, 2013) (cont.)**

**Related Entities**

**Caribbean Utilities Co. Ltd.**

Issuer Credit Rating	A-/Stable/--
Senior Unsecured	A-

**Fortis Alberta Inc.**

Issuer Credit Rating	A-/Stable/--
Senior Unsecured	A-

**Maritime Electric Co. Ltd.**

Issuer Credit Rating	BBB+/Stable/--
Senior Secured	A

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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**McGRAW-HILL**



**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**January 28, 2014**

**UDR 1.30**

Please provide a description of any changes to the cost of debt for TEP, UNS Gas and UNS Electric as a result of the transaction.

**RESPONSE:**

The cost of new long-term debt issued by TEP should be lower as a result of anticipated upgrades of TEP's credit ratings by S&P and Fitch than the cost would otherwise be absent the acquisition. The extent of cost savings to be realized would depend on a variety of factors including (i) the maturity date of the debt being issued, (ii) the extent of the credit rating upgrade(s), and (iii) the interest rate spread demanded by the market for utility bonds at different credit rating levels. Likewise, the cost of short-term debt under TEP's revolving credit facility would be lower as a result of a credit rating upgrade. Under TEP's current revolving credit facility the cost of short-term borrowing would decrease by 12.5 basis points and the cost of TEP's letters of credit would decrease by 12.5 to 25 basis points if either S&P or Moody's increased TEP's credit rating by one notch.

The debt obligations of UNS Gas and UNS Electric are presently rated only by Moody's Service. Moody's has remarked that the merger should be credit neutral to slightly positive for UNS Energy and its subsidiaries. If a ratings upgrade by Moody's were to occur, the cost of new long-term debt issued by UNS Gas and UNS Electric should be lower than it would otherwise be absent the acquisition. With regard to short-term borrowings under the joint revolving credit facility shared by UNS Gas and UNS Electric, a one-notch upgrade from Moody's would also result in a 12.5 basis point reduction to the cost of short-term borrowing.

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.31**

Please provide the pre-acquisition capital structure of the consolidated entity (including UNS Energy and its affiliates) as well as the post-acquisition capital structure of the consolidated entity.

**RESPONSE:**

**UNS Energy Consolidated Capital Structure**

(\$ Thousands)	Pre Acquisition Balance as of 9/30/2013	Pro Forma Adjustments For Acquisition Contribution and Generation Purchases	Post Acquisition Pro Forma Balance
Common Equity	\$1,132,286	\$200,000	\$1,332,286
Long-Term Debt	\$1,505,536	\$157,000	\$1,662,536
Short-Term Debt	\$23,000	-	\$23,000
	\$2,660,822	\$357,000	\$3,017,822
% Common Equity	42.6%		44.1%

Note: Pro forma adjustments reflect anticipated financing for the following generation purchases:

\$219,000	Gila River Unit 3 in December 2014 (75% TEP, 25% UNS Electric)
\$65,000	Springerville Unit 1 in Dec. 2014 and Jan. 2015 (TEP)
<u>\$73,000</u>	Springerville coal handling facilities in April 2015 (TEP)
\$357,000	

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**January 28, 2014**

**UDR 1.32**

If applicable, provide the amount, terms, and purpose of any debt to be issued by UNS Energy in connection with the proposed transaction – or confirm that UNS Energy will issue no debt in connection with the proposal.

**RESPONSE:**

UNS Energy will issue no debt in connection with the merger. However, if the merger is not completed prior to the planned purchase of Gila River Unit 3 by TEP and UNS Electric in December 2014, UNS Energy will borrow on a short-term basis and contribute the proceeds to TEP and UNS Electric to fund a portion of the Gila River purchase price and to TEP for its purchase of a portion of Springerville Unit 1. It is anticipated that any such short-term borrowing by UNS Energy would be paid off upon closing of the merger with Fortis.

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 1, 2014**

**RUCO UNS 2.07**

Please describe the current status of TEP's investigation of and/or plans to sell coal for Springerville Units 1 and 2 to a third party and to buy-back treated coal from the third party for burn at Springerville Units 1 and 2 so that Internal Revenue Code Section 45 (formerly Section 29) credits can be generated.

- a. Does TEP anticipate such an arrangement would reduce its cost of coal to Springerville units 1 and/or 2 during any of the years in the period 2014-2018?
  1. If so, explain briefly the anticipated net reductions in each year.
- b. If TEP's cost of coal to Springerville Units 1 and 2 is reduced by such an arrangement, how would TEP account for the revenue and cost on its books?
- c. Is it TEP's intention that any net reductions to Springerville coal costs generated by such an arrangement be passed through to customers via TEP's PPFAC?
  1. If not, how would TEP treat the net Springerville coal cost reductions associated with such an arrangement for ratemaking purposes?

**RESPONSE:**

TEP is currently in discussions with TCG Global to refine coal which will qualify for tax credits under IRC Section 45(c)(7) and not under IRC Section 29. TCG Global is marketing the project to several tax investors and we plan to proceed as soon as they are successful.

- a. Yes.
  1. The contemplated arrangement is expected to reduce the cost of coal to Springerville between \$1.00/ton and \$2.00/ton in each of the years. If the project begins refining coal by October, 2014 the fuel reduction in 2014 will be approximately \$1.2 Million based on the midpoint of \$1.50 per ton and 800,000 tons burned in the last quarter of 2014. The anticipated reduction in years 2015 through 2018 is approximately \$3.6 Million based on a burn of 2.4 Million tons
- b. As coal is purchased, it is recorded in an inventory account until consumed. In the transaction described in this request, the coal initially would have been recorded to inventory at its original cost. When sold to the third-party, the inventory would be relieved by its original cost, with no gain or loss resulting from that sale. When it was bought-back at a later date, the new lower price would be recorded as the new inventory carrying amount. Accordingly, there are no anticipated costs under the current arrangement, simply a reduction in FERC 501 fuel expenses.
- c. Yes. This benefit will be passed through to customers as a reduction of PPFAC eligible fuel costs.

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 1, 2014**

**RESPONDENT:**

David Jacobs / Jason Rademacher

**WITNESS:**

Kevin Larson

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REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**April 1, 2014**

**RUCO UNS 2.08**

Has TEP or UNS provided any information to Fortis about entering into an arrangement with a third party to generate Section 45 (formerly Section 29) credits for coal treatments at Springerville or any other coal-fired generating plants in which TEP has an ownership or lease interest during the period 2014-2018?

a. If so, please identify and provide such information.

**RESPONSE:**

No.

**RESPONDENT:**

David Jacobs

**WITNESS:**

Kevin Larson

**Defined Terms:**

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.02**

In the Company's application and prefiled testimony was any use of an overseas conduit entity as part of the anticipated financing disclosed?

- a. If so, please identify where this was disclosed.
- b. If not, explain fully why not.

**RESPONSE:**

Fortis provided a high level overview of its plan to finance the acquisition of UNS Energy in the pre-filed testimony of Barry V. Perry. In the pre-filed testimony, it was explained that Fortis plans to finance the acquisition by issuing a combination of common shares, preferred shares and debt financing. This is still the case. Fortis has already secured a substantial portion of the equity financing by issuing C\$1.8 billion of convertible debentures which will convert to common equity once all regulatory and governmental approvals required to finalize the acquisition have been obtained and all other outstanding conditions under the Merger Agreement have been fulfilled or waived.

The use of an overseas conduit entity was not specifically referred to in the joint notice or pre-filed testimony as it represents internal funding of FortisUS by Fortis that was not considered necessary to be included in order to meet the Commission's filing standard. Overseas conduit entities are a commonly used mechanism to finance cross-border transactions in organizations where the parent company resides in Canada and a subsidiary resides in the United States (or vice versa). The use of an overseas conduit entity allows Fortis to take advantage of international tax treaties to finance cross-border subsidiaries. A similar overseas conduit structure was used by Fortis in funding the FortisUS acquisition of CH Energy Group, Inc. in 2013.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.01**

Provide an organizational chart of the proposed Fortis structure that includes all affiliates and their relationships with Fortis, Inc. and FortisUS.

- a. Include any Luxembourg conduit affiliates.

**RESPONSE:**

**RUCO Fortis 2.01 Attachment 1.pdf, Bates No. 002171**, contains a Fortis organizational chart similar to that provided in Exhibit 4 to the Joint Notice of Intent to Reorganize, modified to include the Luxembourg affiliate conduit (i.e., Fortis Energy Corporation, Newfoundland Energy Holdings Inc., and NewfoundlandEnergy Luxembourg S.a.r.l.).

**RESPONDENT:**

Robert Meyers

**WITNESS:**

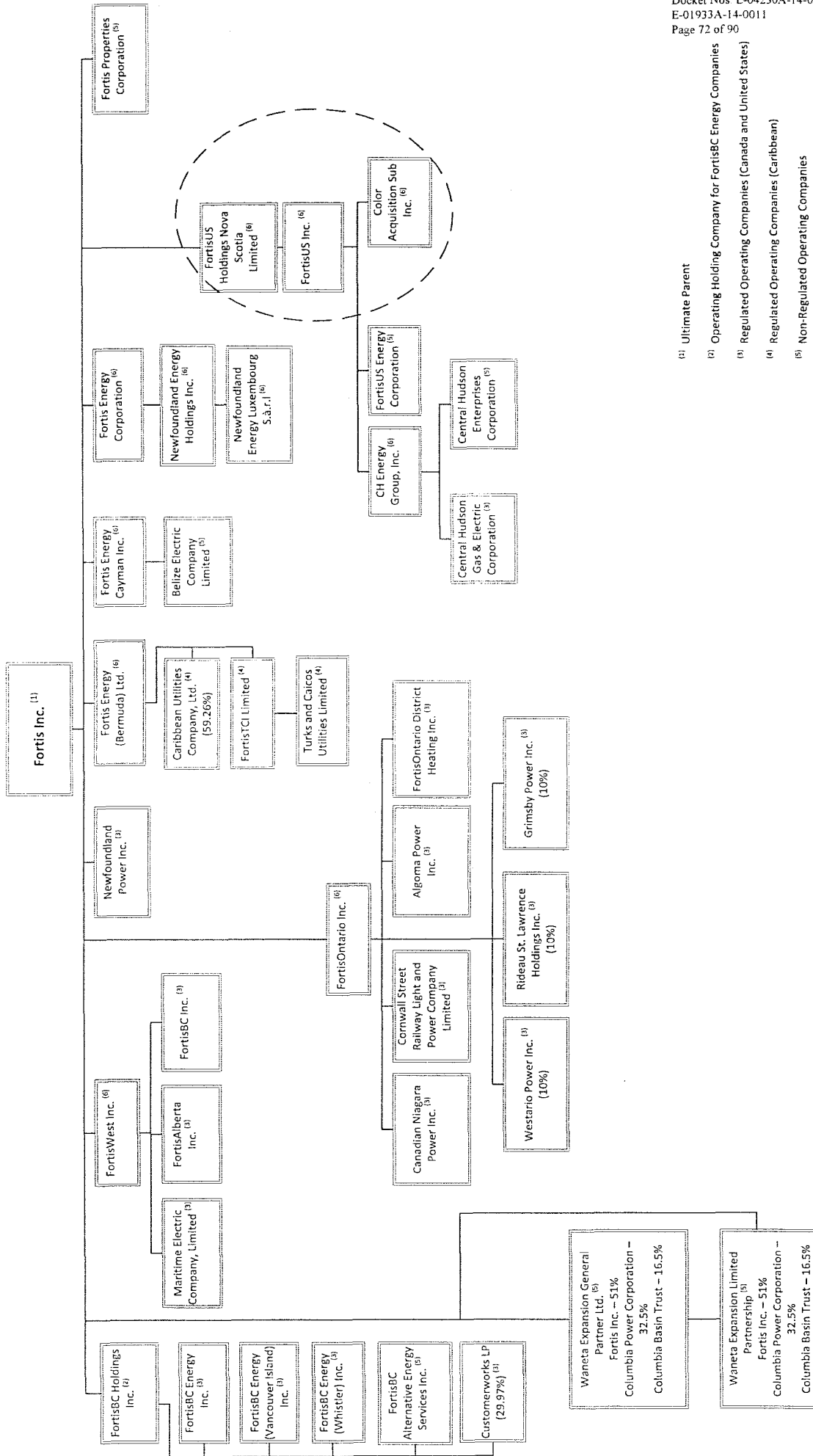
Barry V. Perry

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(1) Ultimate Parent

(2) Operating Holding Company for FortisBC Energy Companies

(3) Regulated Operating Companies (Canada and United States)

(4) Regulated Operating Companies (Caribbean)

(5) Non-Regulated Operating Companies

(6) Internal Holding Companies and Subsidiaries

This chart does not include certain inactive, intermediate or immaterial subsidiaries.

UNS (0011) 002171

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
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**April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.04**

The Fortis Inc. 2013 Annual Report states at pages 57-58:

"Changes in Tax Legislation: In June 2013 Canada enacted legislation relating to the taxation of multinationals, which included new rules, originally proposed on August 19, 2011, relating to upstream loans and a new regime for the repatriation of capital. This new legislation also enacted tax rates to be used for Part VI.1 tax deductions. For further information on Part VI.1 tax, refer to the "Significant Items – Part VI.1 Tax" section of this MD&A."

\*\*\*

"Repatriation of Capital: The new legislation also introduces changes in how earnings can be repatriated to Canada. Earnings are divided into four categories: exempt surplus, taxable surplus, hybrid surplus and pre-acquisition surplus. Historically, earnings were repatriated first from exempt surplus, then taxable surplus and finally pre-acquisition surplus. The new legislation will allow taxpayers to elect which surplus account to use for any repatriation of earnings. However, Canada requires the governments of these tax-free jurisdictions to enter into tax treaties or other comprehensive Tax Information Exchange Agreements ("TIEAs") to access the repatriation rules. Once in force, the TIEAs will permit dividends paid out of active business income to be exempted from tax when received in Canada."

Please identify all entities that Fortis intends to use for repatriation of earnings and dividends from UNS Energy and identify the related amounts of intercompany debt and any impacts on Fortis earnings accretion for years 2015 through the period that Fortis evaluated for due diligence purposes.

**RESPONSE:**

**RUCO Fortis 2.04 Attachment A.xlsx** outlines how the annual dividends of UNS Energy would be repatriated to Fortis Inc., assuming all the forecast dividends were repatriated back to Canada. **RUCO Fortis 2.04 Attachment A.xlsx** also shows payments by FortisUS of interest on intercompany loans from its Luxembourg affiliate, NewfoundlandEnergy Luxembourg S.A.R.L.

*Dividends of UNS Energy to FortisUS*

FortisUS would hold all of the common equity of UNS Energy. Thus, FortisUS would receive all of the dividends paid by UNS Energy. As committed to by Fortis and UNS Energy in the Joint Notice of Intent to Reorganize, the board of directors of UNS Energy will be responsible for the establishment of dividend policy and the declaration of dividends to be paid by UNS Energy.

*FortisUS*

FortisUS is a Delaware corporation and a direct wholly owned subsidiary of FortisUS Holdings Nova Scotia Limited which in turn is a direct wholly owned subsidiary of Fortis Inc.

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FortisUS is also the parent company of CH Energy Group, Inc. and FortisUS Energy Corporation and would also receive dividends from these companies. At December 31, 2013, FortisUS had a capital structure comprised of approximately US\$590 million in common equity and US\$450 million in interest bearing long-term debt from NewfoundlandEnergy Luxembourg S.A.R.L.

The pro-forma capital structure of FortisUS, assuming an acquisition price for UNS Energy equity of US\$2.5 billion and a post-closing common equity injection of US\$200 million, would increase by US\$2.7 billion. The new capital of FortisUS would be comprised of additional common equity of US\$2.2 billion from FortisUS Holding Nova Scotia Limited and additional intercompany loans from NewfoundlandEnergy Luxembourg S.A.R.L. of US\$500 million.

*Payment of UNS Energy Dividends*

Assuming an annual dividend of US\$80 million from UNS Energy to FortisUS, Fortis anticipates that FortisUS would pay interest of US\$25 million on its intercompany loans from NewfoundlandEnergy Luxembourg S.A.R.L. (US\$500 million in loans at an interest rate of 5%). The remaining US\$55 million, if repatriated to Canada, would be paid as a dividend from FortisUS to FortisUS Holdings Nova Scotia Limited. The dividend from FortisUS to its Canadian parent would be subject to a 5% withholding tax in accordance with IRS rules.

FortisUS Holdings Nova Scotia Limited would pay the dividend received from FortisUS, net of the 5% withholding tax, (i.e., US\$52.25 million) as a dividend to Fortis Inc.

*Payment of Interest to Luxembourg Affiliate*

The interest payment of US\$25 million by FortisUS to NewfoundlandEnergy Luxembourg S.A.R.L. would be assessed income tax in Luxembourg of approximately US\$150,000. NewfoundlandEnergy Luxembourg S.A.R.L. would therefore pay a dividend, net of Luxembourg income tax and administrative expenses totaling approximately US\$200,000, (i.e., US\$24.8 million) to its Canadian parent, Newfoundland Energy Holdings Inc. Newfoundland Energy Holdings Inc. would then pay this US\$24.8 million as a dividend to its parent, Fortis Energy Corporation. Fortis Energy Corporation would, in turn, pay US\$24.8 million as a dividend to its parent, Fortis Inc.

**RESPONDENT:**

Robert Meyers

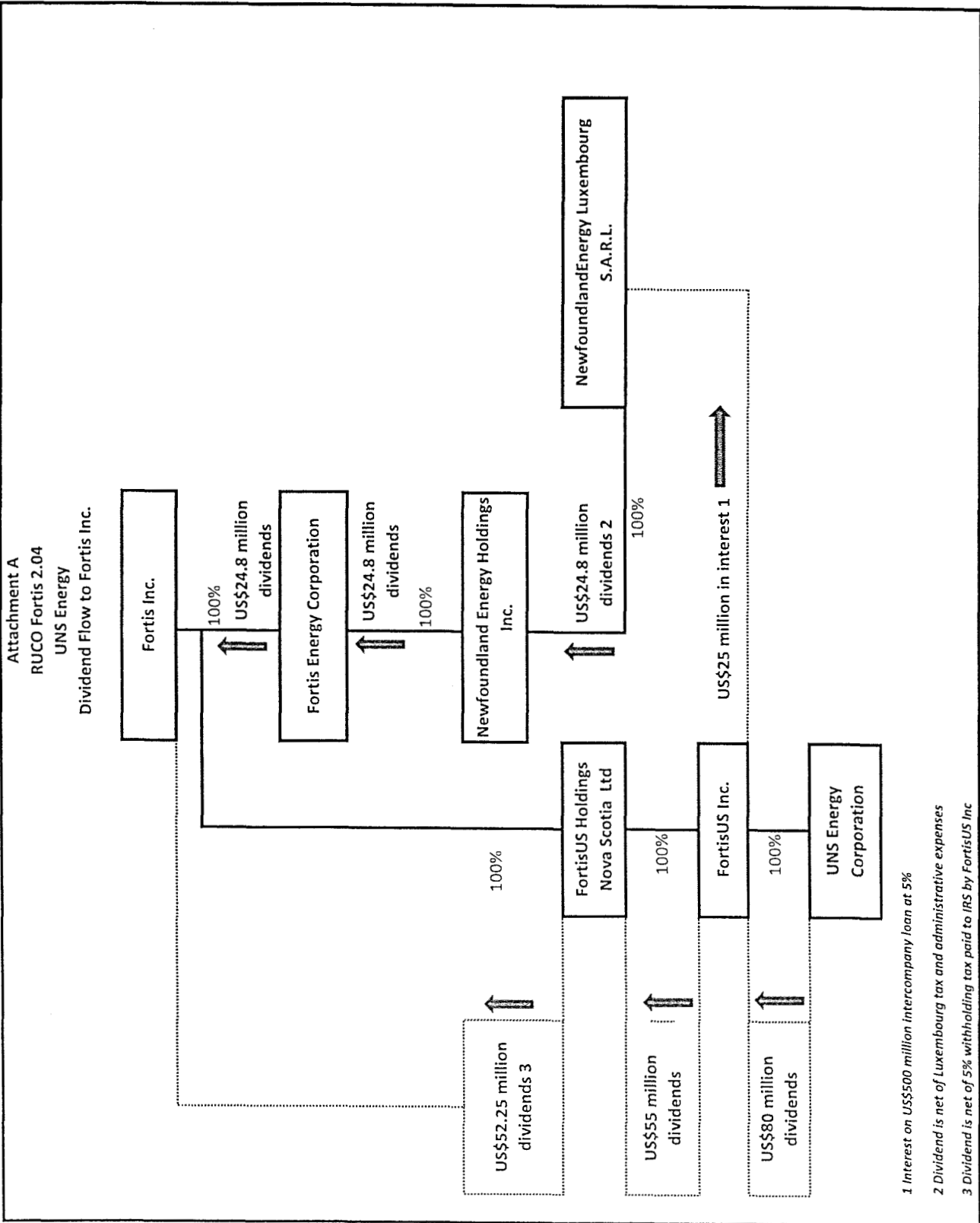
**WITNESS:**

Barry V. Perry

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**RUCO Fortis 2.16**

Is being accretive to Fortis' earnings in the first year (2015) or in other years in the 2015-2018 time period considered to be a critical element to Fortis in pursuing the proposed acquisition of UNS Energy?

- a. Explain fully how important being "accretive to earnings" is to Fortis for this proposed transaction.

**RESPONSE:**

Growth in earnings is as important to Fortis as it is to any successful corporation. Earnings growth supports common share dividend growth and adds shareholder value. This ultimately supports the market price of Fortis common shares and enhances Fortis' access to equity capital. In addition, Fortis funds the growth in its existing regulated operations by retaining a significant portion of earnings at the utility level, supplemented by the provision of common equity injections as required.

To finance the acquisition of UNS Energy, Fortis has issued C\$1.8 billion of securities that are convertible to new equity. The Fortis common share price at which this equity was issued is based on shareholders' expectations that the UNS Energy acquisition will be accretive to earnings.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

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**February 27, 2014**

**RUCO Fortis 1.05**

Refer to NYPSC Case No. 12-M-0192 - Joint Petition of Fortis Inc. et al. and CH Energy Group, Inc. et al. for Approval of the Acquisition of CH Energy Group, Inc. by Fortis Inc. and Related Transactions, NYPSC Order Authorizing Acquisition Subject To Conditions (Issued and Effective June 26, 2013), Joint Proposal for Commission Approval of the Acquisition of CH Energy Group, Inc. by Fortis Inc. and Related Transactions, at page 48 which states as follows: "V. ECONOMIC BENEFITS, INCLUDING SYNERGIES AND POSITIVE BENEFIT ADJUSTMENTS Petitioners have agreed to provide quantified economic benefits comprised of the following synergy and positive benefit adjustments: (i) synergy savings which are guaranteed for a period of 5 years and which will provide for future rate mitigation of \$9.25 million over the 5 years; (ii) a total of \$35 million of combined write-offs of deferred regulatory assets and future rate mitigation funds; and, (iii) one-time funding of \$5 million for a Community Benefit Fund for economic development and low income purposes."

- a. What is the annual Central Hudson regulated utility revenue for each of the five years up to the acquisition by Fortis.
- b. What percent does the \$9.5 million of synergy savings represent of the Central Hudson regulated annual utility revenue?
- c. What percent does the \$5 million of Community Benefit Fund represent of the Central Hudson regulated annual utility revenue?
- d. Show in detail how the \$35 million of combined write-offs of deferred regulatory assets and future rate mitigation funds has been accounted for and applied. Include journal entries recorded by the Central Hudson regulated utilities as of the date of the Fortis acquisition and subsequently to reflect this.

**RESPONSE:**

- a. Central Hudson Gas & Electric Corp.'s annual regulated utility revenues for the last five years are as follows:

2013	\$668.4 million
2012	\$644.5 million
2011	\$700.5 million
2010	\$719.9 million
2009	\$710.5 million

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**February 27, 2014**

- b. The 5-year synergy savings of \$9.25 million represents 1.38% of Central Hudson's 2013 regulated utility revenue.<sup>3</sup>
- c. The \$5 million Community Benefit Fund represents 0.75% of Central Hudson's 2013 regulated utility revenue.
- d. **RUCO Fortis 1.05 Attachment A.pdf, Bates Nos. 001805-001808**, contains the Central Hudson journal entries and related work papers with respect to both the \$35 million and \$5 million regulatory liabilities and related authorized offsets.

Page 1 contains the journal entry recorded upon acquisition (June 2013) showing how the \$35 million and \$5 million regulatory liabilities were recorded, including related deferred federal and state income taxes.

Page 2 provides the calculated allocation of the \$35 million regulatory liability between electric and gas, after offset of authorized storm restoration costs referred to in the NYPSC Order. Page 2 also shows the remaining balances of \$11,654,322 and \$3,008,526 million for electric and gas, respectively, that continue to be available for future rate mitigation as will be determined by the NYPSC at some later date.

Page 3 provides the calculated allocation of the \$5 million Community Benefit Fund amount between electric and gas.

Page 4 includes a summary of the offset of the storm charges against the \$35 million regulatory liability.

**RESPONDENT:**

Michael Mosher, Central Hudson Gas & Electric Corporation

**WITNESS:**

Barry V. Perry

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<sup>3</sup> The annual synergy savings of \$1.85 million (i.e., \$9.25 million / 5 years) represents 0.28% of Central Hudson's 2013 regulated utility revenue.

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CENTRAL HUDSON G. & E. CORP.	TRANSACTION 410	Month of	June 2013	Journal Voucher No.	06 - 600
	PSC, REV or RPT #	Account	Payroll Area	Amount	CR
Regulatory Debits	407.30	40730-1-940		35,965,573	
Regulatory Debits	407.30	40730-2-940		4,034,427	
Regulatory Liability - PBA - ELECTRIC	254.83	0823A		(20,337,152)	CR
Regulatory Liability - PBA - ELECTRIC	254.83	0823A		(11,654,322)	CR
Regulatory Liability - PBA - GAS	254.84	0844A		(3,008,526)	CR
Regulatory Liability - Customer Benefit Fund - Electric	254.70	0873A		(3,974,099)	CR
Regulatory Liability - Customer Benefit Fund - Gas	254.70	0876A		(1,025,901)	CR
Deferred FIT - PBA Funds (Electric)	410.13	41246-1-930		(11,197,000)	CR
Deferred FIT - PBA Funds (Electric)	190.12	19012-3-970		11,197,000	
Deferred SIT - PBA Funds (Electric)	410.17	41247-1-930		(1,476,400)	CR
Deferred SIT - PBA Funds (Electric)	192.12	19212-3-970		1,476,400	
Deferred FIT - PBA Funds (Gas)	410.14	41246-2-930		(1,053,000)	CR
Deferred FIT - PBA Funds (Gas)	190.13	19013-3-970		1,053,000	
Deferred SIT - PBA Funds (Gas)	410.18	41247-2-930		(138,800)	CR
Deferred SIT - PBA Funds (Gas)	192.13	19213-3-970		138,800	
Deferred FIT - Use of CBA Funds (Electric)	410.13	41251-1-930		(1,390,900)	CR
Deferred FIT - Use of CBA Funds (Electric)	190.78	19078-3-970		1,390,900	
Deferred SIT - Use of CBA Funds (Electric)	410.17	41252-1-930		(183,400)	CR
Deferred SIT - Use of CBA Funds (Electric)	192.78	19278-3-970		183,400	
Deferred FIT - Use of CBA Funds (Gas)	410.14	41251-2-930		(359,100)	CR
Deferred FIT - Use of CBA Funds (Gas)	190.78	19078-3-970		359,100	
Deferred SIT - Use of CBA Funds (Gas)	410.18	41252-2-930		(47,300)	CR
Deferred SIT - Use of CBA Funds (Gas)	192.78	19278-3-970		47,300	

THE ESTABLISHMENT OF A REGULATORY LIABILITY FOR THE \$35M OF PBA's and \$5M OF  
CUSTOMER BENEFIT FUND AS OUTLINED IN THE JOINT PROPOSAL

Prepared By:

Approved:

Total Debits

55,845,900.00

Total Credits

(55,845,900.00)

CR

Journal  
Voucher No.

06 0

UNS (0011) 001805



Central Hudson Gas & Electric Corporation  
Case 12-M-0192  
Allocation Method of PBA's - Customer Benefit Fund

Allocation Basis:

	<u>Rate Year 3</u>	(1)	<u>Allocation</u>
Electric Delivery Revenues	286,062		79%
Gas Delivery Revenues	<u>73,846</u>		<u>21%</u>
	359,908		100%

(1) Per Cases 09-E-0588 & 09-G-0589, Joint Proposal, Appendix A, Schedule 2.

Allocation of \$35 Million of PBA's:

	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
Allocation Percentage	79%	21%	100%
Amount of PBA - Customer Benefit Fund			35,000,000
Less: Deferred Irene Storm Costs (Actual)			(8,919,779)
Less: Deferred October 2011 Storm Costs (Actual)			-
Less: Deferred Sandy Storm Costs (Estimate)			(10,165,126)
Less: Deferred Carrying Charges on Irene			(967,556)
Less: Deferred Carrying Charges on October 2011			-
Less: Deferred Carrying Charges on Sandy			<u>(284,691)</u>
Balance Available for Future Mitigation			<u>14,662,848</u>
Allocation of Remaining Balance After Storm Offset	<u>11,654,322</u> ✓	<u>3,008,526</u> ✓	<u>14,662,848</u>

Central Hudson Gas & Electric Corporation  
Case 12-M-0192  
Allocation Method of PBA's - Economic Development

Allocation Basis:

	<u>Rate Year 3</u> (1)	<u>Allocation</u>
Electric Delivery Revenues	286,062	79%
Gas Delivery Revenues	<u>73,846</u>	<u>21%</u>
	359,908	100%

(1) Per Cases 09-E-0588 & 09-G-0589, Joint Proposal, Appendix A, Schedule 2.

Allocation of \$5 Million for Economic Development:

	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
Allocation Percentage	79%	21%	100%
Allocation of \$5 million of CBF	3,974,099	1,025,901	5,000,000
	✓	✓	

CENTRAL HUDSON G. & E. CORP. TRANSACTION 410		Month of	June 2013	Journal Voucher No.	06
	PSC, REV or RPT #	Account	Payroll Area	Amount	CR
Use of PBA - Storm Offset	254.83	0824A		① 19,084,905	
Use of PBA - Storm CC Offset	254.83	0841A		1,252,247	
Storm Deferral - August 2011 Storm Costs	182.35	7126A		(8,919,779)	CR
Storm Deferral - October 2012 Storm Costs	182.35	8779A		(10,165,126)	CR
Storm Deferral - August 2011 Storm Costs	182.47	7127A		(967,556)	CR
Storm Deferral - October 2012 Storm Costs	182.47	8820A		(284,691)	CR
Deferred FIT - PBA Funds (Electric)	190.12	19012-3-970		(6,679,700)	CR
Deferred FIT - Storm Deferrals	283.85	5364A-3-620		6,679,700	
Deferred SIT - PBA Funds (Electric)	192.12	19212-3-970		(880,800)	CR
Deferred SIT - Storm Deferrals	284.85	5365A-3-620		880,800	
Deferred FIT - PBA Funds (Electric)	190.13	19013-3-970		(438,300)	CR
Deferred FIT - CC - Storm Deferrals	283.10	28310-3-970		438,300	
Deferred SIT - PBA Funds (Electric)	192.13	19213-3-970		(57,800)	CR
Deferred SIT - CC - Storm Deferrals	284.10	28410-3-970		57,800	

TO OFFSET THE STORM DEFERRALS AND ASSOCIATED CARRYING CHARGES WITH USE OF THE PBA DOLLARS ESTABLISHED UNDER THE JOINT PROPOSAL

① = 20,337,152

Prepared By:	Approved:	Total Debits	28,393,752.00	
		Total Credits	(28,393,752.00)	CR

Journal Voucher No. 06 0

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**RUCO Fortis 2.29**

How does Fortis anticipate the corporate costs will be impacted by merger?

- a. How does Fortis intend to account for these increased corporate costs? (Show accounting entries and identify the entity upon whose books such costs are being recorded. Include any accounting entries to allocate or charge such costs to other entities.)
- b. Does Fortis intend to charge any of these increased Fortis corporate costs to any of the Arizona utilities (TEP, UNSE or UNSG)?
  1. If so, show the estimated amounts for each year and identify and explain what services are being provided associated with such costs.

**RESPONSE:**

Fortis estimates that the merger will increase its annual corporate general and administrative costs by approximately C\$700,000.

- a. Illustrative accounting entries for the C\$700,000 in incremental costs and the entity recording each entry are shown in **RUCO Fortis 2.29 Attachment 1.xlsx**.
- b. Fortis Inc. utilizes a cost allocation method to calculate management fees charged to its subsidiaries. The allocation to subsidiaries is calculated as a proportion of Fortis Inc.'s corporate expenses, as per below, excluding: (i) finance charges associated with credit facilities and long-term debt; (ii) 50% of salary and salary-related expenses of Fortis Inc.'s CEO, CFO and Treasurer; and (iii) 100% of business development costs. The allocable costs are charged to the operating subsidiaries based on the percentage of their assets to the total consolidated assets of Fortis Inc.

Fortis Inc.'s costs (i.e., corporate expenses) typically relate to public capital market access related to investment in operating subsidiaries. Such costs include governance costs, capital market fees, public reporting requirements, trustee fees, common share plans and other related fees. These costs are allocated between regulated and non-regulated operations by each operating subsidiary as required under appropriate local regulatory guidelines governing that operating subsidiary. Generally, capital market costs related to equity are regarded as costs which are appropriately allocated to regulated operations (because the costs benefit the regulated subsidiary and are not duplicative), whereas costs such as those related to governance may not be allocated to regulated operations (because the regulated subsidiary has its own independent board of directors and additional governance costs tend to be duplicative).

For additional information on Fortis' cost allocation methodology, please refer to **RUCO Fortis 2.29 Attachment 2.pdf**, Bates Nos. 002180-002209, which contains a June 22, 2009 report from KPMG pertaining to a review of the cost allocation methodology utilized by Fortis Inc. This report reviewed the cost allocation policy of Fortis Inc. as well as FortisBC Holdings Inc. (formerly known as Terasen Gas Inc.). Fortis Inc. would

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**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

allocate applicable costs to its subsidiaries, including UNS Energy Corporation, in accordance with the indicated methodology. The methodology used by UNS Energy to allocate costs to its subsidiaries is described in UDR 1.14.

The merger and contemporaneous delisting of UNS Energy will eliminate many of the public company costs now being incurred by UNS Energy and its subsidiaries. Additionally, UNS Energy and its subsidiaries will be able to take advantage of cost saving opportunities, where appropriate: a prominent example being the Fortis group insurance program that allows participating subsidiaries to lower their insurance premiums. Consequently, total operating costs borne by the regulated subsidiaries of UNS Energy will not increase from what they otherwise would have been in the absence of the merger and should, in fact, decrease.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

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**RUCO Fortis 2.29 Attachment 1**  
**Illustrative Accounting Entries**  
**Allocation of Fortis Inc Incremental Corporate Costs**  
**(C\$ thousands)**

	<u>Debit</u>	<u>Credit</u>
<b><u>Fortis Inc. Books</u></b>		
<b>JE 1</b>		
Corporate Expenses	700	
Accounts Payable		700
To record incurrence of estimated incremental corporate expenses.		
<b>JE 2</b>		
Income Tax Payable	203	
Income Tax Expense		203
To record tax shield on incremental corporate expenses at the Fortis Inc marginal income tax rate of 29%.		
<b>JE 3</b>		
Accounts receivable - UNS Energy Corporation	xxx	
Accounts receivable - various subsidiaries	xxx	
Corporate expenses		xxx
To record chargeback of certain corporate expenses to the subsidiaries of Fortis Inc in accordance with established allocation methodology.		
<b>JE 4</b>		
Income Tax Expense	xxx	
Income Tax Payable		xxx
To record lost income tax shield on chargeback of incremental corporate expenses at the Fortis Inc marginal income tax rate of 29% (amounts are 29% of the total corporate expenses charged back in JE 3).		
<b><u>UNS Energy Corporation Books</u></b>		
(Note: Amounts would also be recorded by other Fortis subsidiaries based on a percentage allocation as described in the response to RUCO Fortis 2.29)		
<b>JE 5</b>		
Corporate Expenses	xxx	
Accounts Payable - Fortis Inc		xxx
To record corporate expenses charged back to UNS Energy Corporation by Fortis Inc per JE 3 above.		
<b>JE 6</b>		
Income Tax Payable	xxx	
Income Tax Expense		xxx
To record income tax shield on Fortis Inc corporate expenses charged back to UNS Energy Corporation at the US statutory income tax rate of 35% (amounts are 35% of the corporate expenses charged back in JE 5).		

**RUCO Fortis 2.29 Attachment 1**  
**Illustrative Accounting Entries**  
**Allocation of Fortis Inc Incremental Corporate Costs**  
**(C\$ thousands)**

	<u>Debit</u>	<u>Credit</u>
<b>JE 7</b>		
Accounts Receivable - Non Regulated Subsidiaries	xxx	
Accounts Receivable - Regulated Subsidiaries	xxx	
Corporate Expenses		xxx
To record chargeback of certain corporate expenses to subsidiaries.		
Amounts charged back to regulated subsidiaries are determined by		
UNS Energy Corporation management based on the appropriate		
local regulatory guidelines.		

<b>JE 8</b>		
Income Tax Expense	xxx	
Income Tax Payable		xxx
To record lost income tax shield on chargeback of corporate		
expenses to subsidiaries at the US marginal income tax rate of 35%		
(amounts are 35% of the total corporate expenses charged back in JE 7).		

**UNS Energy Corporation Subsidiaries Books**

(NOTE: The methodology used by UNS Energy to allocate costs to its subsidiaries is described in UDR 1.14)

<b>JE 9</b>		
Corporate Expenses	xxx	
Accounts Payable - UNS Energy Corporation		xxx
To record corporate expenses charged back by UNS Energy Corporation		
to its subsidiaries in JE 7.		

<b>JE 10</b>		
Income Tax Payable	xxx	
Income Tax Expense		xxx
To record income tax shield on corporate expenses charged back		
by UNS Energy Corporation at the US statutory income tax rate of 35%		
(amounts are 35% of the corporate expenses charged back in JE 9).		

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.14**

Please describe UNS Energy's and its utility subsidiaries' current cost allocation methodology.

**RESPONSE:**

The approach to allocating costs between UNS Energy and its subsidiaries is designed to share the costs of common or jointly used equipment, space and shared service employees in an equitable and systematic way. Whenever possible, time is tracked on a direct project basis to allow for direct billing to the benefiting subsidiary. When that is not possible, various allocation methods may be used. The exact allocation methodology may differ between types of cost, but the underlying principle remains the same, to identify the determining driver that most closely represents the benefit incurred and allocate appropriately. For example; a shared payroll system might be charged out based on employee headcount, while a shared billing system on number of bills produced.

Where elements of cost causation cannot be reasonably or economically identified as the basis for allocation, a residual factor is applied to the allocation pool. The residual factor used by TEP is a three-factor formula, based on an equal weighting of payroll costs, plant/tangible assets, and total revenues. Such formula, known as the "Massachusetts Formula" has been widely used throughout the utility industry, has been accepted by the Cost Accounting Standards Board, and is consistent with the manner by which taxable income is partitioned between states under UDITPA and the Multistate Tax Compact.

These cost allocation procedures used by UNS Energy and its utility subsidiaries' (the Companies) to allocate annual affiliated costs follow the cost allocation procedures and cost causative concepts that were filed and approved as a part of the formation of UNS Energy as a holding company for TEP [Commission Decision No. 60480 (November 25, 1997)].

The methodology underlying the allocations are described in the cost allocation procedures approved by the Commission in Commission Decision No. 60480 (November 25, 1997) and Commission Decision No. 62767 (August 2, 2000).

**RESPONDENT:**

Frank Marino and Brian Brumfield

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
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FortisUS Inc. ("FortisUS")

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UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")



**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.08**

If and after it acquires UNS Energy, does Fortis intend to continue to seek other acquisitions of utilities in the United States (or elsewhere)?

**RESPONSE:**

Fortis will continue to assess acquisition opportunities in Canada and the United States that may arise from time to time. These would be limited to regulated utilities and hydroelectric generation opportunities with long term contracts. Fortis currently does not intend to pursue opportunities outside these two countries.

Currently, Fortis is not assessing other acquisition opportunities and is focused on completing the acquisition of UNS Energy. In the near term, Fortis expects to focus on organic growth opportunities within its regulated utilities.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

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UNS Gas, Inc. ("UNS Gas")

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-K**

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2013

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the transition period from to .

Commission  
File Number

1-13739

Registrant, State of Incorporation;  
Address; and Telephone Number

**UNS ENERGY CORPORATION**  
(An Arizona Corporation)  
88 East Broadway Boulevard  
Tucson, AZ 85701  
(520) 571-4000

IRS Employer  
Identification Number

86-0786732

1-5924

**TUCSON ELECTRIC POWER COMPANY**  
(An Arizona Corporation)  
88 East Broadway Boulevard  
Tucson, AZ 85701  
(520) 571-4000

86-0062700

Securities registered pursuant to Section 12(b) of the Exchange Act:

<u>Registrant</u>	<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
UNS Energy Corporation	Common Stock, no par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Exchange Act:

<u>Registrant</u>	<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Tucson Electric Power Company	Common Stock, without par value	N/A

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.

UNS Energy Corporation

Yes ☒

No ☐

Tucson Electric Power Company

Yes ☐

No ☒

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Regulatory liabilities represent items that we either expect to pay to customers through billing reductions in future periods or plan to use for the purpose for which they were collected from customers, as described below:

- (7) Net Cost of Removal for Interim Retirements represents amounts recovered through depreciation rates associated with asset retirement costs expected to be incurred in the future.
- (8) The Deferred Investment Tax Credit relates to federal energy credits generated in 2012 and is amortized over the tax life of the underlying asset.

## IMPACTS OF REGULATORY ACCOUNTING

If we determine that we no longer meet the criteria for continued application of regulatory accounting, we would be required to write off our regulatory assets and liabilities related to those operations not meeting the regulatory accounting requirements. Discontinuation of regulatory accounting could have a material impact on our financial statements.

## NOTE 4. BUSINESS SEGMENTS

We have three reportable segments regularly reviewed by our chief operating decision makers to evaluate performance and make operating decisions.

- (1) TEP, a regulated electric utility and our largest subsidiary
- (2) UNS Electric, a regulated electric utility
- (3) UNS Gas, a regulated gas distribution utility

We disclose selected financial data for our reportable segments in the following tables:

	Reportable Segments				Reconciling Adjustments	UNS Energy
	TEP	UNS Electric	UNS Gas	Other <sup>(2)</sup>		
	Millions of Dollars					
<b>2013</b>						
<b><u>Income Statement</u></b>						
Operating Revenues-External	\$ 1,180	\$ 174	\$ 131	\$ 2	\$ (2)	\$ 1,485
Operating Revenues-Intersegment <sup>(1)</sup>	17	2	3	17	(39)	—
Depreciation and Amortization	149	19	9	—	—	177
Interest Income	—	1	—	—	—	1
Interest Expense	79	7	6	1	—	93
Income Tax Expense	48	7	7	(4)	—	58
Net Income	101	12	11	3	—	127
<b><u>Cash Flow Statement</u></b>						
Capital Expenditures	(253)	(56)	(17)	—	—	(326)
<b><u>Balance Sheet</u></b>						
Total Assets	3,556	404	311	1,194	(1,192)	4,273

**UNS Energy Corporation and Fortis Inc.**  
**Docket Nos. E-04230A-14-0011 and E-01933A-14-0011**  
**Attachment RCS-6**  
**Copies of UNS Energy and Fortis Inc.'s Confidential Responses to Data Requests**  
**and Workpapers Referenced in the Direct Testimony of**  
**Ralph C. Smith**

**\*\*UNS and Fortis Confidential Pages Have Been Redacted\*\***

<b>Data Request/ Workpaper No.</b>	<b>Subject</b>	<b>Confidential</b>	<b>No. of Pages</b>	<b>Page No.</b>
RUCO Fortis 2.32	REDACTED	Yes	3	2 - 4
RUCO UNS 1.04	REDACTED	Yes	3	5 - 7
RUCO Fortis 2.11	REDACTED	Yes	3	8 - 10
RUCO UNS 2.02	REDACTED	Yes	3	11 - 13
Total Pages Including this Page			13	

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.32**

Does Fortis anticipate incurring costs or expenses for Change in Control payments for UNS officers/employees.

- a. If yes, what expense or cost does Fortis anticipate?
- b. If yes, how does Fortis intend to account for these costs? (Show accounting entries and identify the entity upon whose books such costs are being recorded. Include any accounting entries to allocate or charge such costs to other entities.)
- c. If yes, does Fortis intend to charge any of these change in control costs to any of the Arizona utilities (TEP, UNSE or UNSG)?
  1. If so, show the estimated amounts for each year and identify and explain what services are being provided associated with such costs.

**RESPONSE:**

**THE FILE LISTED BELOW CONTAINS CONFIDENTIAL INFORMATION AND IS BEING PROVIDED PURSUANT TO THE TERMS OF THE PROTECTIVE AGREEMENT.**

Please see **RUCO Fortis 2.32 Response-Confidential.pdf**, Bates No. 002212-002213, for the requested information.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

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UNS Gas, Inc. ("UNS Gas")

RUCO Fortis 2.32 Response-Confidential.pdf

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
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REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
February 28, 2014**

**RUCO UNS 1.04**

Refer to page 19 of the UNS Energy Corporation SEC 8-K filing which addresses change in control payments.

- a. Identify each change in control payment that is anticipated.
- b. Provide the pro forma journal entries showing how the change in control payments would be recorded.

**RESPONSE:**

**THE FILE LISTED BELOW CONTAINS CONFIDENTIAL INFORMATION AND IS BEING PROVIDED PURSUANT TO THE TERMS OF THE PROTECTIVE AGREEMENT.**

- a.-b. Please see RUCO UNS 1.04-Confidential.pdf, Bates Nos. 001809-001810, for the requested information.

**RESPONDENT:**

Frank Marino / Brian Brumfield

**WITNESS:**

Kevin Larson

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REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.11**

Retention payments and retention bonuses. Are any payments being made or anticipated to be made in order to retain any employees of TEP, UNS Electric, UNS Gas or other UNS Energy affiliates?

- a. If so, identify all committed or anticipated retention payments or retention bonuses, and show how they are to be accounted for (provide journal entries).
- b. Also, identify the amounts for any committed or anticipated retention payments or retention bonuses, and the period in which they have been or would be recorded.
- c. Does Fortis agree that such payments to retain existing employees of TEP, UNS Electric, UNS Gas or other UNS Energy affiliates so such employees are available subsequent to the acquisition/merger are a transaction cost and should not be borne by the ratepayers of TEP, UNS Electric or UNS Gas?
  1. If not, explain fully why not.

**RESPONSE:**

**THE FILE LISTED BELOW CONTAINS CONFIDENTIAL INFORMATION AND IS BEING PROVIDED PURSUANT TO THE TERMS OF THE PROTECTIVE AGREEMENT.**

Please see RUCO Fortis 2.11 Response-Confidential.pdf, Bates No. 002004-002005, for the requested information.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

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**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**April 1, 2014**

**RUCO UNS 2.02**

Retention payments and retention bonuses. Are any payments being made or anticipated to be made in order to retain any employees of TEP, UNS Electric, UNS Gas or other UNS Energy affiliates?

- a. If so, identify all committed or anticipated retention payments or retention bonuses, and show how they are to be accounted for (provide journal entries).
- b. Also, identify the amounts for any committed or anticipated retention payments or retention bonuses, and the period in which they have been or would be recorded.
- c. Does Fortis [We think you mean UNS.] agree that such payments to retain existing employees of TEP, UNS Electric, UNS Gas or other UNS Energy affiliates so such employees are available subsequent to the acquisition/merger are a transaction cost and should not be borne by the ratepayers of TEP, UNS Electric or UNS Gas?
  1. If not, explain fully why not.

**RESPONSE:**

**THE FILE LISTED BELOW CONTAINS CONFIDENTIAL INFORMATION AND IS BEING PROVIDED PURSUANT TO THE TERMS OF THE PROTECTIVE AGREEMENT.**

Please see RUCO UNS 2.02 Response-Confidential.pdf, Bates No. 001998-001999, for the requested information.

**RESPONDENT:**

Frank Marino / Brian Brumfield

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
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**UNS Energy Corporation and Fortis Inc.**  
**Docket Nos. E-04230A-14-0011 and E-01933A-14-0011**  
**Attachment RCS-7**  
**Copies of Confidential UNS Energy's Due Diligence Documentation**  
**Referenced in the Direct Testimony of**  
**Ralph C. Smith**

**\*\*Contains UNS Energy CONFIDENTIAL Information Has Been Redacted\*\***

UNS Page No.	Subject	Highly Confidential and Competitively Sensitive	Confidential Information	No. of Pages	Page No.
REDACTED	REDACTED	No	Yes		
REDACTED	REDACTED	No	Yes		
Total Pages Including this Page				1	

Note: On April 30, 2014 counsel for UNS Energy advised that the attached two pages can be treated as "Confidential" rather than Highly Confidential and Competitively Sensitive  
Pages 2 and 3 are not included in the Redacted version of this attachment

REORGANIZATION OF UNS ENERGY CORPORATION

DOCKET NO. E-04230A-14-0011

DOCKET NO. E-01933A-14-0011

DIRECT TESTIMONY

OF

LON HUBER

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

APRIL 30, 2014

**TABLE OF CONTENTS**

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<b>POTENTIAL BENEFITS OF ACQUISITION .....</b>	<b>3</b>
<b>RATEPAYER AND PUBLIC INTEREST CONSIDERATIONS.....</b>	<b>6</b>

**INTRODUCTION**

**Q. Please state your name, position, employer and address.**

A. Lon Huber. I am a special projects advisor for Arizona's Residential Utility Consumer Office ("RUCO"), located at 1110 W. Washington, Suite 220, Phoenix, AZ 85007.

**Q. Please state your educational background and work experience.**

A. I started working in the energy field in 2007 at a research institute housed within the University of Arizona. In 2010, I became the governmental affairs staffer for TFS Solar, an integrator based in Tucson. I was hired by Suntech America in 2011 as a Manager of Regional Policy where I served as the point person for the company in numerous US states. Next, I started working in economic development as a senior analyst for the Greater Phoenix Economic Council while also serving as a consultant for RUCO on energy issues. I joined RUCO as a full time employee in January 2014.

I obtained a Bachelor of Science Public Administration degree in Public Policy and Management from the University of Arizona in 2009. I also received a Masters of Business Administration from the Eller College of Management at the same university. My primary residence is in Tucson Arizona.

**Q. Please state the purpose of your testimony.**

A. The purpose of my testimony is to present recommendations that are based on my review of the acquisition from a public policy perspective only. My testimony will specifically touch on whether or not this proposed transaction is in the public interest.

1 **Q. What are the standards that you relied on in determining whether or not an**  
2 **acquisition of UNS Energy by Fortis is in the public interest?**

3 A. I relied upon A.A.C. R14-2-803(C) and Decision No. 67454  
4

5 **OVERVIEW OF ACQUISITION**

6 **Q. Please provide a high-level overview of the proposed transaction.**

7 A. Fortis, a large publicly traded Canadian gas and electric distribution utility<sup>1</sup>, plans to  
8 acquire all of the outstanding common stock of UNS Energy for \$60.25 per share in  
9 cash.<sup>2</sup> Upon completion, UNS Energy will cease being a publicly traded company.  
10

11 **Q. Please comment on suitability of the two companies coming together.**

12 A. Fortis has acquired several other Canadian utilities and one U.S. utility over recent years  
13 and now serves 2.4 million customers across all of its utilities.<sup>3</sup> Like UNS Energy, the  
14 primary business of Fortis is in the provision of utility services. Their management  
15 philosophy is that of local control and Fortis appears to be a company that takes a long-  
16 term view when acquiring companies. UNS Energy in particular would be a large  
17 addition to the Fortis's portfolio. The acquisition provides diversity to that portfolio that  
18 can strengthen Fortis in numerous ways. By being an integral part of Fortis, UNS Energy  
19 may gain improved access to debt and equity capital due to the relative financial  
20 strength of Fortis.  
21  
22

23 

---

<sup>1</sup> Fortis trades under the symbol FTS on the Toronto stock exchange.

24 <sup>2</sup> <http://ir.uns.com/releasedetail.cfm?ReleaseID=835639>

<sup>3</sup> Direct Testimony Mr. Kevin Larson page 3

1 **Q. Briefly summarize the major conditions of approval as submitted by the**  
2 **applicants.**

3 A. The central conditions of the agreement between Fortis and UNS Energy include but not  
4 limited to the following:

- 5 • Agreement to maintain a high level quality of service across UNS Energy's  
6 regulated subsidiaries. This includes the commitment to maintain a low level  
7 of complaints and service interruptions.
- 8 • Commitment to keep UNS Energy Arizona based and operated.
- 9 • Provide equity capital when required and \$200 million of equity infusion upon  
10 closing.
- 11 • Commitment to continue current union contracts, employee levels and  
12 benefits.
- 13 • Commitment to maintain current levels of community support and donations.
- 14 • Costs related to merger including any goodwill, acquisition premium, and  
15 transaction costs will be borne by Fortis shareholders and will not be  
16 recouped from ratepayers.

17 **POTENTIAL BENEFITS OF ACQUISITION**

18 **Q. How does RUCO view the potential benefits of this transaction?**

19 A. As the transaction is currently structured, there are clear benefits to both companies but  
20 an absence of tangible and material near term benefits to ratepayers - even though  
21 significant benefits can be realized. Furthermore, the benefits that are mentioned by  
22 UNS Energy and Fortis are indeterminate and long-term and could be negated by risks  
23 produced from this deal.

24 **Q. Please explain.**

A. Fortis gains a well-run utility in the context of a steadily consolidating industry. With the  
acquisition, Fortis brings diversity to its portfolio and the opportunity to make a sizable  
amount of rate base eligible investments in the near term. Fortis estimates that the

1 acquisition will be accretive to its earnings, excluding the impact of transaction costs.  
2 UNS Energy shareholders receive a premium for their stock while executives of UNS  
3 Energy are protected and also share in the stock premium.  
4

5 In terms of benefits to ratepayers, the deal offers zero commitment to delivering any  
6 specific benefit. From the ratepayers view, the companies are committing to the status  
7 quo with the possibility of positive side effects down the road. However, as detailed in  
8 Ralph Smith's testimony, there may also be ratepayer exposure to long-term risks.  
9

10 **Q. Please describe these risks.**

11 A. The acquisition is expected to result in a substantial amount of goodwill, currently  
12 estimated at over \$1.4 billion, to be recorded. If a large amount of impairment is realized  
13 on this non-revenue producing asset, raising capital in the future may be more difficult  
14 and expensive. Moreover, having such a large additional amount of goodwill would be  
15 expected to put pressure on Fortis management to keep earnings high and thereby  
16 avoid having to recognize an impairment. This pressure may manifest itself in different  
17 ways that may or may not be in the best long-term interest of ratepayers. This  
18 uncertainty may be digestible if the transaction contained additional safeguards and  
19 tangible near term benefits to ratepayers. However, the acquisition as currently  
20 proposed, is lacking benefits and a few key safeguards.  
21  
22  
23  
24

1 **Q. Could you be more specific on the lack of near term benefits to ratepayers?**

2 A. In Mr. Hutchens's testimony, he noted that cost savings might be realized by ratepayers  
3 after the next rate case.<sup>4</sup> He did not state or guarantee an exact number. Similarly, Mr.  
4 Larson made a claim on potential future cost savings but did not specify timing or an  
5 amount.<sup>5</sup> In Fortis' recent acquisition of Central Hudson Gas & Electric Corporation  
6 savings were guaranteed - \$9.25 million was guaranteed to customers over five years.<sup>6</sup>  
7 In addition, \$5 million was set aside in a Customer Benefit Fund to be used for economic  
8 development and low-income assistance programs. Additionally, conditions imposed on  
9 Fortis' Central Hudson acquisition required that \$35 million provided to Central Hudson  
10 by Fortis be recorded as a regulatory liability to be applied to write off regulatory assets  
11 on the books of Central Hudson for storm restoration and to provide balance sheet  
12 offsets and rate mitigation in Central Hudson's next rate filing. Finally, the level of  
13 community support was guaranteed for 10 years, instead of the five Fortis is offering in  
14 this case.

15  
16 **Q. Are there near terms savings that can be realized by ratepayers?**

17 A. Yes, UNS Energy will be assimilated into a larger and more sophisticated entity that has  
18 access to financial techniques and tools that can deliver direct savings to ratepayers. As  
19 mentioned, it is not unprecedented for Fortis to grant and guarantee near term savings  
20 to ratepayers. Moreover, Fortis was able to provide \$49 million in customer benefits to  
21 Central Hudson's ratepayers, a utility roughly half the size of UNS Energy.

22  
23 <sup>4</sup> Direct Testimony Mr. David Hutchens page 5

<sup>5</sup> Direct Testimony Mr. Kevin Larson page 10

24 <sup>6</sup> <https://www.fortisinc.com/News/Pages/Fortis-Acquisition-of-CH-Energy-Group,-Inc--Approved-by-New-York-State-Public-Service-Commission.aspx>



**Q. What level of savings would you recommend in this case?**

A. As discussed in Ralph Smith's testimony, RUCO is seeking \$59 million in ratepayer benefits. These benefits can be delivered over time and applied against different accounts and/or adjustors such as the Lost Fixed Cost Recovery adjustor. Again, this amount is reasonable compared to the savings Fortis agreed to in the company's last acquisition. In fact, if savings were proportional to the size of the Central Hudson transaction, UNS Energy ratepayers would receive around \$100 million in savings.

#### **RATEPAYER AND PUBLIC INTEREST CONSIDERATIONS**

**Q. In addition to the lack of tangible benefits are there other conditions that should be imposed upon the transaction?**

A. Yes. There are additional conditions which are described more fully in Ralph Smith's testimony. These important conditions are summarized below:

1. Fortis and UNS Energy agree to share any follow-on merger savings that are reasonably applicable to TEP, UNS Electric and UNS Gas.
2. Fortis and UNS Energy agree and commit that none of the shareholder litigation costs shall be borne by the ratepayers of TEP, UNS Electric or UNS Gas.
3. Fortis and UNS Energy to agree and commit that all Change of Control costs and Retention Bonus costs are transaction costs and none of those costs shall be borne by the ratepayers of TEP, UNS Electric or UNS Gas.
4. Fortis and UNS Energy to agree and commit that all tax benefits of the plans to sell coal to third parties will be passed onto TEP ratepayers through the PPFAC.
5. Fortis and UNS Energy shall report to the Commission within five business days any changes in the credit ratings of Fortis, Inc., UNS Energy, TEP, UNS Electric or UNS Gas.

**Q. What is your understanding of the public interest standard that the Commission applies for approval or rejection of a notice of intent to reorganize?**

A. A.A.C. R14-2-803(C) states that: "At the conclusion of any hearing on the organization or reorganization of a utility holding company, the Commission may reject the proposal if it determines that it would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service." However, the Commission has previously elaborated on the standard. In Decision No. 67545, (January 4, 2005 Docket No. E-04230A-03-0933 at page 49<sup>7</sup>) the Commission concluded that the factors set out in A.A.C. R14-2-803(C) are only a part of the "public interest" inquiry that the Commission must make as part of its consideration of the proposed transaction:

5. Pursuant to the Arizona Constitution and A.R. S. Title 40 generally, the Commission is required to act in the "public interest" and must consider all of the evidence available in determining the "public interest".
6. The public interest requires that the Commission apply the Affiliated Interest Rules in a manner that will maximize protection to ratepayers.
7. Utility ratepayers should not be required to bear the burden of risk resulting from holding company structure or diversification.
8. The factors set out in A.A.C. R14-2-803(C) are only a part of the "public interest" inquiry that the Commission must make as part of its consideration of the proposed transaction.

Based on this guidance RUCO believes that the standard of review is broad and that the Commission's review must consider all of the evidence available in determining the

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<sup>7</sup> This proceeding involved a previous attempt to sell UniSource Energy.

1 "public interest" and apply the Affiliated Interest Rules in a manner that will maximize  
2 protection to ratepayers.

3  
4 **Q. Would the acquisition impair the financial status of the public utility?**

5 A. Probably not directly given Fortis' financial position and better credit rating. Fortis'  
6 current financial strength could enhance the financial status of UNS Energy and UNS  
7 Energy's access to capital at favorable rates, which is one reason why RUCO could  
8 support the transaction provided that the near term benefits and safe guard issues as  
9 described above are adequately addressed. However, there is a risk that the additional  
10 goodwill of over \$1.4 billion (which Fortis has committed will not be recovered from  
11 Arizona ratepayers) could ultimately result in impairing Fortis' financial strength if Fortis  
12 has to recognize impairment losses to the value of that goodwill in future accounting  
13 periods.

14  
15 **Q. Would the acquisition prevent the utility from attracting capital at fair and**  
16 **reasonable terms?**

17 A. No, again the transaction does not appear to present any near-term issues with the  
18 ability of the utility to attract capital on reasonable terms. Again, it should enhance the  
19 ability of UNS Energy to attract capital because of the stronger financial position that  
20 could result by the merger. However, as noted above, the transaction will result in  
21 Fortis recording additional goodwill of over \$1.4 billion, which could ultimately result in a  
22 future impairment to Fortis' financial strength if the significant amounts of goodwill that  
23 Fortis has been accumulating from its acquisition of UNS Energy and its other recent  
24 acquisitions become impaired.

1  
2 **Q. Would the acquisition impair the ability of the utility to provide safe, reasonable**  
3 **and adequate service?**

4 A. Not in the near term, and not in the intermediate term, as long as Fortis is able to  
5 maintain its financial strength prospectively while taken on the increasing financial  
6 burdens of carrying large additional amounts of goodwill on its books that are not  
7 recoverable through utility rates. As noted above, there is a concern that the amounts of  
8 goodwill that Fortis is recording may ultimately result in impairment write-downs that  
9 could imperil Fortis' financial strength.

10  
11 **Q. Does the acquisition maximize protection to ratepayers?**

12 A. No. Additional safe guards are needed, including monetary guarantees to help render a  
13 net positive deal for ratepayers.

14  
15 **Q. Is the acquisition in the public interest?**

16 A. If the conditions specified in this testimony and Ralph Smith's testimony are met, the  
17 acquisition would be in the public interest. As currently proposed, the acquisition has  
18 clear near-term benefits for UNS Energy shareholders (stock price premium), to UNS  
19 Energy executives (financial benefits from stock based compensation, Change-in  
20 Control payments, etc.) and to Fortis (earnings accretion, diversity enhancement, etc.)  
21 but no near-term tangible benefits to the ratepayers of the three Arizona Utilities.  
22 Moreover, taking on an additional \$1.4 billion of goodwill that is not going to recoverable  
23 from ratepayers, and which is roughly seven times the amount of Fortis' \$200 million  
24 committed equity infusion in to UNS Energy, could ultimately result in the impairment of

1 Fortis' financial strength, thus jeopardizing the potential benefit of improved access to  
2 capital on reasonable terms that is promised by the proposed transaction.  
3

4 **Q. Does RUCO recommend approval of the merger?**

5 A. RUCO can endorse the proposed merger if the additional conditions outlined in this  
6 testimony are met. RUCO is concerned that the significant amount of additional goodwill  
7 resulting from the proposed transaction could ultimately result in future impairments to  
8 Fortis' financial strength, thus impairing or negating the potential benefits of improved  
9 access to capital markets on reasonable terms. RUCO is also troubled by the lack of  
10 quantifiable near term benefits to ratepayers. As mentioned, tangible ratepayer benefits  
11 were guaranteed in the conditions applied to Fortis' only other acquisition of a U.S.  
12 based utility, i.e., its acquisition of the Central Hudson utilities in New York in 2013.  
13 Given these facts, RUCO would support the merger only if Fortis makes a firm  
14 commitment to deliver tangible and quantifiable savings to ratepayers and grants the  
15 safeguards mentioned above.  
16

17 **Q. Does this conclude your testimony?**

18 A. Yes it does.  
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